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March 28, 2008

Inspector General

United States

Department *of* Defense



Controls Over Army
Real Property Financial
Reporting

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Acronyms

ACSIM	Assistant Chief of Staff for Installation Management
AGF	Army General Fund
ASA(FM&C)	Assistant Secretary of the Army (Financial Management and Comptroller)
AWCF	Army Working Capital Fund
CIP	Construction-in-Progress
DCD/DCW	DFAS Corporate Database/DFAS Corporate Warehouse
DFAS	Defense Finance and Accounting Service
DoD FMR	DoD Financial Management Regulation
DPAS	Defense Property Accountability System
DUSD(I&E)	Deputy Under Secretary of Defense (Installations and Environment)
GAO	Government Accountability Office
GAAP	Generally Accepted Accounting Principles
GFEBS	General Fund Enterprise Business System
GLAC	General Ledger Accounting Code
IFS	Integrated Facilities System
LMP	Logistics Modernization Program
OUSD(C)/CFO	Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer
RPAO	Real Property Accountability Officer
SFFAS	Statement of Federal Financial Accounting Standards
SIFS	Standard Industrial Fund System
USACE	U.S. Army Corps of Engineers



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March 28, 2008

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE
(COMPTROLLER)/CHIEF FINANCIAL OFFICER
DEPUTY UNDER SECRETARY OF DEFENSE
(INSTALLATIONS AND ENVIRONMENT)
AUDITOR GENERAL, DEPARTMENT OF THE ARMY
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Report on Controls Over Army Real Property Financial Reporting
(Report No. D-2008-072)

We are providing this report for review and comment. We considered comments from the Office of the Under Secretary of Defense (Comptroller), Department of the Army, and Defense Finance and Accounting Service when preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Deputy Chief Financial Officer's comments were responsive. However, the comments from the Army and Defense Finance and Accounting Service were only partially responsive. Therefore, we request additional comments on Recommendations B.1., B.2., and C.3.b. by April 28, 2008.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to AUDDFS@dodig.mil. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Carmelo G. Ventimiglia at (317) 510-4801, ext. 275 (DSN 699-4801) or Mr. George C. DeBlois at (317) 510-4801, ext. 273 (DSN 699-4801). See Appendix E for the report distribution. The team members are listed inside the back cover.

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Report No. D-2008-072

(Project No. D2006-D000FI-0249.000)

March 28, 2008

Controls Over Army Real Property Financial Reporting

Executive Summary

Who Should Read This Report and Why? DoD personnel responsible for real property accountability and financial reporting should read this report. It discusses the processes and controls needed to ensure accurate and complete financial reporting of real property assets.

Background. A well-designed process for reporting real property on financial statements employs standard data elements and transaction processes, consistent internal controls, and efficient transaction entry. DoD real property consists of land, buildings, and other structures; improvements to owned or leased real property assets; and real property assets under construction.

The Army reports real property assets on the financial statements for the Army Working Capital Fund (AWCF), the Army General Fund, and the U.S. Army Corps of Engineers, Civil Works. Real property acquisition costs reported on the FY 2006 AWCF Financial Statements consisted of \$2.2 billion in buildings and other structures, \$95 million in leasehold improvements, and \$37 million in construction-in-progress. This is the first of two reports related to the controls over AWCF real property assets.

Results. DoD and the Army have made progress in standardizing data elements and processes to reduce redundancies and other inefficiencies in reporting real property. However, the DoD preponderance-of-use policy and Army practices for reporting AWCF and Army General Fund real property assets did not comply with accounting principles generally accepted in the United States. As a result, the Army did not prepare its financial statements in accordance with those principles and misstated the acquisition cost of real property assets on the FY 2006 AWCF and Army General Fund Financial Statements by \$424.3 million from six judgmentally selected sites. To report real property assets accurately, DoD needs to replace the preponderance-of-use policy with a costing method for assigning costs to the real property users. The Army must ensure compliance with the new costing methodology and correct misstatements in the Army financial statements (Finding A).

The Army did not implement a uniform business process for creating a subsidiary ledger file to support the accountability and financial reporting of its real property assets. Maintaining two different business processes was inefficient and resulted in inaccurate and incomplete real property data in subsidiary ledger files. The Army should develop a common process for Army entities to establish and maintain subsidiary ledger files, depreciate real property, and pass financial data to the financial statements. The process should employ the same system functionality and monthly cutoff date. In addition, the Army should reconcile the data in its real property management and accounting systems. As the Army develops and implements future accounting systems, it should develop the functionality to generate subsidiary ledger data at the installation level for financial

reporting purposes. As an interim measure, the Army should send all financial transactions to the Defense Finance and Accounting Service (DFAS) Corporate Database/DFAS Corporate Warehouse and work with DFAS to develop the capabilities in the Army accounting systems to retrieve needed financial transactions from DFAS Corporate Database/DFAS Corporate Warehouse. Once that is accomplished, Army should expand the capabilities of the AWCF Integrated Facilities System databases and stop using the Defense Property Accountability System as an Army real property system (Finding B).

The Army did not accurately and efficiently transfer construction-in-progress costs between its accounting and property management systems. As a result, Army could not ensure the accuracy and completeness of the acquisition costs of its real property assets. Also, the Army expended resources to perform duplicate entry of cost data into its systems. The Army needs to be able to transfer construction costs from the construction agent to the installations that will account for the real property assets. In addition, the Army should develop system capabilities in accounting systems to capture all of the relevant construction costs and send acquisition costs to the property management systems when placing assets in service. Until the Army can integrate its systems, it should require resource managers to enter acquisition costs manually into the Integrated Facilities System. In addition, DoD needs to update the DoD Financial Management Regulation to require DoD entities to record the transfer in of assets to the appropriate general ledger accounting code (Finding C). See the Findings section of the report for the detailed recommendations.

Management Comments and Audit Response. The Deputy Chief Financial Officer agreed with the need to update the DoD Financial Management Regulation to develop new business rules for defining financial control over real property assets and implementing a costing methodology that complies with generally accepted accounting principles. He also agreed with updating the DoD Financial Management Regulation to record assets transferred in to the appropriate general ledger account. However, he did not agree with the need to rescind the preponderance-of-use policy. The Deputy Chief Financial Officer's comments were responsive. His plan to define financial control and imputed costing methods for real property assets will meet the intent of our recommendations.

The Deputy Assistant Secretary of the Army (Financial Operations), in coordination with functional stakeholders from the Army Budget Office, Office of the Assistant Chief of Staff for Installation Management, and the U.S. Army Materiel Command, concurred with our recommendations. He agreed to identify and record real property assets on the proper financial statements and train real property personnel on the new costing methodology. The Deputy Assistant Secretary also agreed with the need for uniform processes for reporting and periodically reconciling real property and added that our recommended actions were part of ongoing General Fund Enterprise Business System business transformation efforts and conversion preparations. He stated that if a substantial delay in system implementation occurred, he would consider making interim changes to the business process for reporting Army real property assets. He also stated that because the General Fund Enterprise Business System would subsume the Integrated Facilities System, there was no need to develop a system interface with the accounting systems. The Deputy Assistant Secretary agreed to work with other responsible Army offices to develop the necessary system requirements in the General Fund Enterprise Business System and develop an interim process for recording acquisition costs until the system

functionality exists. He also agreed to work with DFAS and the U.S. Army Corps of Engineers to develop an approach for transferring construction-in-progress costs to the appropriate AWCF installations.

The Director for DFAS Indianapolis Operations nonconcurred with Recommendations B.1. and C.4. He stated that we should redirect issues related to the DFAS Corporate Database/DFAS Corporate Warehouse to the Business Transformation Agency and methods for transferring construction-in-progress costs to the Army. He stated that DFAS would support the Army's efforts.

The Deputy Assistant Secretary's comments were partially responsive. We agree that developing an interface with the Integrated Facilities System is unnecessary if the General Fund Enterprise Business System subsumes these functions. However, the Army will need to ensure that it integrates AWCF and Army General Fund systems to properly record real property transactions. We do not agree with the Army's position not to develop an interim solution for improving the financial reporting of its real property assets. The current processes do not accurately report its real property assets, and the Army has already developed a real property initiative within the DFAS Corporate Database/DFAS Corporate Warehouse that DFAS can use to report AWCF real property assets. The initiative, if properly implemented, would give the Army the ability to reconcile and consistently report its real property assets, while developing the subsidiary data ledger data needed to transition to the General Fund Enterprise Business System. The Army and DFAS must work together to develop a plan for using the data collected within the DFAS Corporate Database/DFAS Corporate Warehouse to report real property assets. Furthermore, we do not agree that the Army can wait until the fielding of future systems to restrict real property personnel from recording acquisitions costs in the Integrated Facilities System. However, we agree with DFAS that the Army should have the lead role in developing a method for transferring construction-in-progress costs to the appropriate AWCF installation. Consequently, we revised Recommendation C.4., and consider the Army comments on this recommendation to be responsive. See the Findings section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of the comments.

We request that the Army and DFAS reconsider their positions on Recommendations B.1., B.2., and C.3.b. and provide additional comments on the final report by April 28, 2008.

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Background

DoD real property assets consist of land; buildings and other structures; improvements to owned or leased real property assets; and real property construction-in-progress (CIP). The Army reports real property assets on the financial statements for the Army Working Capital Fund (AWCF), the Army General Fund (AGF), and the U.S. Army Corps of Engineers (USACE), Civil Works. The Army reports all of its land assets on the AGF financial statements.

The AWCF is composed of the Industrial Operations and the Supply Management, Army activity groups.¹ The AWCF Industrial Operations activity group reported more than 19,000 real property assets at 13 installations. The Supply Management Army activity group reported only three real property assets as of September 30, 2006. The table shows the acquisition cost and book value of real property assets reported on the FY 2006 AWCF Financial Statements. See Appendix B for a glossary of terms used throughout the report.

AWCF Real Property Costs		
Asset Class	Acquisition Cost (in millions)	Book Value* (in millions)
Land	\$ 0.0	\$ 0.0
Buildings, Structures, and Facilities	2,231.9	793.1
Leasehold Improvements	95.2	16.2
CIP	36.5	36.5
Total	\$2,363.6	\$845.8

*Book value is the acquisition cost of assets less accumulated depreciation on those assets.

Real Property Responsibilities

The U.S. Army Assistant Chief of Staff for Installation Management (ACSIM) manages Army real property assets. ACSIM employees enter all real property accountability information in the Integrated Facilities System (IFS) but financially process AWCF and AGF real property assets differently. For AWCF real property assets, IFS sends real property records to the Defense Property Accountability System (DPAS) to calculate depreciation. DPAS then provides AWCF financial transactions to the accounting systems. The AWCF uses data from three accounting systems to report the value of real property assets in the financial statements. It uses data from the Standard Industrial Fund System (SIFS) and the Logistics Modernization Program (LMP) system for the Industrial Operation activity group.² It also uses the Standard Operations and Maintenance, Army Research and Development System for the Supply Management, Army

¹ Activity groups are business areas used to identify the organizational structure, assets, and liabilities of an Army operation.

² The Army Program Executive Office, Enterprise Information Systems manages LMP. The Program Executive Office, Enterprise Information Systems also oversees the General Fund Enterprise Business System, which will become the AGF accounting system.

activity group. See Appendix C for a more detailed discussion of the systems involved in the AWCF real property process. For AGF real property assets, IFS calculates depreciation before sending the financial transactions to the DFAS Corporate Database/DFAS Corporate Warehouse (DCD/DCW).

The Assistant Secretary of the Army (Financial Management and Comptroller) (ASA[FM&C]) is responsible for the policies, procedures, programs, and systems pertaining to finance and accounting. DFAS provides finance and accounting services to the Military Departments. DFAS Indianapolis consolidates financial information from the accounting systems, compiles other information sent in from data calls, and makes adjustments as necessary to prepare the AWCF and AGF financial statements.³

Integrated System Requirements

Financial management systems are used to track financial events, provide financial information, and prepare financial statements. Office of Management and Budget Circular No. A-127, “Financial Management System,” July 1993, prescribes policies and standards for Federal entities to develop, operate, and evaluate financial management systems that will be used for financial reporting. The circular states that entities should design their financial management systems to provide for effective and efficient interrelationships among software, hardware, personnel, procedures, controls, and data contained within the system. Financial management systems should have the following characteristics:

- common data elements that establish and use standard data classification for recording financial events;
- common transaction processes throughout the system to ensure consistent reporting of similar transactions;
- consistent internal controls over data entry, transaction processing, and reporting throughout the system to ensure the validity of information and protection of Federal Government resources; and
- efficient transaction entry. The financial data should enter the financial system only once and automatically update the other parts of the system as necessary.

DoD Financial Management Regulation

DoD Financial Management Regulation (DoD FMR), volume 4, “Accounting Policy and Procedures,” chapter 6, “Property, Plant, and Equipment,” July 2006, contains the DoD accounting standards for Property, Plant, and Equipment. The

³ DFAS Indianapolis is located in Indianapolis, Indiana.

regulation establishes the requirements for capitalizing and depreciating real property assets. Except for land and CIP, DoD entities must depreciate real property assets during their useful lives.

DoD Initiatives

For many years, DoD has had significant problems accounting for real property assets. DoD real property managers have recognized the need for standardized data elements and processes to reduce redundancy and other inefficiencies, address material weaknesses, and enhance asset accountability. In November 2003, the Deputy Under Secretary of Defense (Installations and Environment) (DUSD(I&E)) established a real property working group to develop uniform requirements to capture and process real property transactions. The working group issued three documents addressing standard processes, data elements, and business rules for real property inventory, acceptance, and CIP.⁴ Since January 2006, ACSIM has implemented many policy and system changes to bring IFS into compliance with the new DoD requirements.

Objectives

The overall audit objective was to determine whether controls over AWCF real property assets were in place and providing reasonable assurance that the AWCF organizations had proper asset management. This is the first of two reports concerning the controls over AWCF real property assets. This report will specifically address whether Army entities had effectively implemented the DoD preponderance-of-use policy and whether the interfaces in place between the real property management and accounting systems provided reasonable controls over the financial reporting of real property assets. To help assess the business process used by AWCF entities for real property transactions, we compared it with the process used for AGF entities. The second report will address the remaining announced audit objectives concerning controls over additions, deletions, and improvements to real property assets; and the availability of documentation needed to support real property records. See Appendix A for a discussion of the scope and methodology and for prior coverage related to the objectives.

Review of Internal Controls

We identified material internal control weaknesses for the Army as defined by DoD Instruction 5010.40, “Managers’ Internal Control Program Procedures,” January 4, 2006. We reviewed the internal controls related to the processing of data between real property management and accounting systems. Army did not

⁴ The DUSD(I&E) issued the following documents to improve real property controls: “Real Property Inventory Requirements,” January 2005; “Real Property Acceptance Requirements,” August 2006; and “Construction-In-Progress Requirements,” September 2006.

have sufficient internal controls in place to ensure that the subsidiary ledger source data contained in real property management systems supported the real property values reported on its AWCF and AGF financial statements. The Army also did not maintain sufficient controls over the real property cost information transferred between the accounting and property management systems. The Army recognized the reliability of property, plant, and equipment values as an area of concern in its FY 2007 Annual Statement of Assurance.

Recommendations B and C, when implemented, will improve the processing of AWCF real property transactions. We will provide a copy of the final report to the senior Army official responsible for internal controls.

A. DoD Preponderance-of-Use Policy

The DoD preponderance-of-use policy and Army practices for reporting AWCF and AGF real property assets did not comply with accounting principles generally accepted in the United States (GAAP). Specifically, the DoD preponderance-of-use policy did not ensure that DoD entities:

- reported assets on the controlling entity's financial statements;⁵
- allocated costs to the appropriate users based on their use of assets; and
- disclosed costs incurred which were paid in total or in part by other entities as prescribed by DoD FMR, volume 4, chapter 17, "Expenses and Miscellaneous Items."

The DoD preponderance-of-use policy was noncompliant with GAAP because it perpetuated a previously established accounting convention that GAAP does not recognize. In addition, the Army installations had misinterpreted and incorrectly implemented the DoD preponderance-of-use policy. As a result, the Army did not prepare its financial statements in accordance with GAAP. The Army misstated the acquisition cost of real property assets on the FY 2006 AWCF and AGF financial statements by \$424.3 million.

Preponderance-of-Use Requirements

DoD FMR, volume 4, chapter 6, states that legal ownership is usually, but not always, the primary factor for determining which DoD Component recognizes a real property asset for accounting and financial statement reporting purposes. The regulation contains a policy that requires the "preponderant user" of an asset to report the total value of the asset and associated costs on its financial statements. When there is more than one user of an asset, the user that has the greater percentage of usage (square footage for real property) normally will be the preponderant user.

The DoD FMR applies the preponderance-of-use policy differently depending on whether the preponderant user is a Military Department general fund, Defense general fund, or a Defense working capital fund entity. When a working capital fund entity is the preponderant user of a real property asset under the jurisdiction of a Military Department, the working capital fund entity reports and depreciates the asset on its financial statements.

⁵ See Appendix B for a definition of controlling entity.

Compliance with Accounting Principles

The DoD preponderance-of-use policy does not comply with GAAP as established in Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," July 31, 1995. The lack of a systematic cost accounting process resulted in the introduction of the DoD policy as an interim solution to account for the cost of real property assets. The policy inappropriately allowed DoD entities to report real property assets on their financial statements when they did not fund the construction or financially document their assumption of control over the assets. In addition, the policy required the preponderant user to record the full value of the assets on its financial statements, including the cost of operations incurred by other users. This policy overstated the cost of operations of the preponderant user and understated the cost of operations for both the entity having financial control over the asset and other users of the asset. Furthermore, the DoD FMR did not require the preponderant user to report on its financial statement the financing source for the assets used.

Although DoD FMR, volume 4, chapter 17, provided guidance on the reporting of imputed costs, the preponderance-of-use policy established in DoD FMR, volume 4, chapter 6, did not direct the imputing of the costs associated with real property assets when an entity who does not control the asset benefits from use of the asset. Furthermore, the DoD policy for asset recognition did not clearly define the concept of asset control, or ensure that the correct entity recorded the asset on its financial statements. In most cases, the entity that funds an asset is the controlling entity, unless it formally transfers the financial control of the asset to another entity after placing the asset in service.

The Government Accountability Office (GAO), in its January 20, 2000, memorandum regarding changes to DoD FMR, volume 4, chapter 6, stated that under the DoD preponderance-of-use policy, the preponderant user of an asset, not necessarily the owner, would report the asset on its balance sheet and depreciation on its statement of net cost. The memorandum also stated that although GAO supported this policy in a previous version of the DoD FMR, SFFAS No. 4 did not reflect this accounting convention, and the policy was not compliant with GAAP.

SFFAS No. 4 requires an entity to report the full cost of its outputs in its financial statements, including any costs incurred on its behalf, such as the cost to use real property assets. The costs should include the sum of:

- the cost of resources consumed that directly or indirectly contribute to the output and
- the cost of identifiable supporting services provided by other entities, known as inter-entity costs.

SFFAS No. 4 specifies that receiving entities should recognize any material inter-entity costs that they do not fully reimburse to the provider at full cost. In other words, the receiving entity should recognize the difference between any costs

incurred on its behalf by another DoD entity and any actual reimbursement it makes to that entity as an imputed financing source. The receiving entity also should record a corresponding imputed cost for costs not reimbursed.

Pending Change in Policy. The working group developing the Department's Real Property Inventory Requirements recognized the need to develop a long-term solution that would provide the capability to allocate the cost of real property assets basis to each user on a prorated regardless of funding source, in accordance with SFFAS No. 4. In June 2007, the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer (OUSD[C]/CFO), Accounting and Finance Policy Directorate, formed a work group to evaluate the issue. On May 24, 2007, we issued a memorandum, "Replacing Preponderance-of-Use Policy with Imputed Costing," (Appendix D) that recommended the rescission of the DoD preponderance-of-use policy and the development of a costing methodology for the financial reporting of all real property assets that was in accordance with SFFAS No. 4. The costing methodology must allocate cost data to the appropriate entities based on their use of real property assets. Furthermore, the users should recognize the cost of the real property by either fully reimbursing the cost to the entity holding jurisdiction over the asset or by recognizing any unreimbursed portion as an imputed financing source and expensing a corresponding imputed cost in their financial statements.

Implementing a Revised Real Property Reporting Process. Rescinding the DoD preponderance-of-use policy would require the Military Departments to reassess how they report real property assets. Initially, the DoD Office of Inspector General and other entities expressed concerns that the reporting of real property assets on Defense agency or Defense working capital fund financial statements would violate section 2682, title 10, United States Code.⁶ However, in September 2007, the OUSD(C)/CFO obtained a legal opinion that clarified that the financial reporting of real property assets was separate from the requirements contained in section 2682. Therefore, Defense agencies or Defense working capital fund entities can financially report real property assets.

Based on this guidance, the OUSD(C)/CFO should rescind the current DoD preponderance-of-use policy and establish business rules for implementing a costing methodology for recording DoD real property assets. The business rules should clearly define the concept of financial control over real property assets and require DoD entities that financially control assets to report them on their financial statements. The business rules should also require entities to report any capital improvements procured with their funds and require the entity that financially reports an asset to comply with the imputed costing requirements contained in DoD FMR, volume 4, chapter 17, by providing other users of the asset with a notification of the imputed costs associated with their use.

Implementing this full costing methodology to report Military Department real property assets procured using Military Department funds would require that:

⁶ Real property facilities under DoD jurisdiction that are used by a DoD entity or agency (other than a Military Department) are under the jurisdiction of a Military Department designated by the Secretary of Defense.

-
- the Army report assets procured with appropriated funds as part of the AGF financial statements and assets procured with working capital funds on the AWCF financial statements, unless formal transfer of control to another entity occurs after placing an asset in service;
 - the Army identify the costs incurred by the controlling entity for the benefit of other users and allocate those costs to the appropriate users; and
 - the non-controlling entities either reimburse the controlling entity for their portion of the costs or record any unreimbursed costs as an imputed cost.

When a Defense agency or a Defense working capital fund entity spends its funds to construct an asset it will control, the Defense agency or defense working capital fund entity should report the asset in its financial statements and transfer accountability to a Military Department only when the entity places the asset in service.

Army Implementation

Army practices for reporting AWCF and AGF real property assets did not comply with GAAP. The Army tried to implement the DoD preponderance-of-use policy, but few real property personnel at the five AWCF installations we visited understood how to interpret or implement the policy. Real Property Accountability Officers (RPAOs) at AWCF installations, who entered real property information in IFS, incorrectly believed that they should report all the assets they accounted for as AWCF assets.

AGF Assets Reported by AWCF. Industrial Operations activity group installations erroneously reported the acquisition costs of AGF real property assets in IFS. Based on our review of real property data at six AWCF installations, the Army misstated both the AWCF and AGF financial statements by \$424.3 million as of September 30, 2006 (see Appendix A for the dollar value of errors by installation).⁷ The RPAOs at these AWCF installations should have determined that AGF entities paid for and occupied these buildings and structures. Based on this information, they should have entered users' unit identification codes in the proper IFS field. However, the Army did not ensure compliance with the guidance on how to determine the correct financial reporting requirement for the asset. For example,

- The Anniston Chemical Disposal Facility, an AGF entity, is the preponderant user of 28 real property assets at Anniston Army Depot, Alabama. The Anniston Chemical Disposal Facility constructed the assets using appropriated funds and solely occupied the facilities.

⁷ In addition to the five installations we visited (Rock Island Arsenal, Tobyhanna Army Depot, Anniston Army Depot, Corpus Christi Army Depot, and Crane Army Ammunitions Activity), we reviewed real property data from Pine Bluff Arsenal.

However, the Army reported the cost of the 28 assets on the AWCF financial statements instead of the AGF financial statements. As a result, the Army misstated the acquisition cost of real property assets on both the AWCF and AGF financial statements by \$155.5 million.

- The Army Reserve Command, an AGF entity, was the occupant of a building at Tobyhanna Army Depot, Pennsylvania, built with AGF funds. The Army incorrectly reported the building as an AWCF asset. As a result, the AWCF financial statements were overstated by \$1.7 million, the acquisition cost of the building, and the AGF financial statements were understated by \$1.7 million.

The inability to identify the correct reporting entity at Army installations is a systemic problem and may have caused the misreporting of additional AGF facilities located on other AWCF installations. For example, Note 10 to the FY 2005 AWCF Financial Statements reported an increase in the acquisition cost of real property assets by \$267.1 million because of the construction of a chemical disposal facility at the Pine Bluff Arsenal, Arkansas. Installation personnel and ACSIM should have identified the chemical disposal facilities, which are funded with chemical demilitarization appropriations, as AGF assets when they placed them into service. Based on this audit, the Army Budget Office directed the Anniston Army Depot and Pine Bluff Arsenal to prepare journal vouchers to remove these facilities from the AWCF and report them as part of the FY 2007 AGF Financial Statements. In addition, it validated that all other chemical disposal facilities were reported correctly in the AGF financial statements. ASA(FM&C) needs to identify any other facilities located at the 13 AWCF installations funded and used by an AGF entity and report them on the AGF financial statements.

AWCF Assets Reported by the AGF. AWCF entities did not accurately report the cost associated with their use of real property assets at AGF installations. ACSIM designed an indicator to identify which entity was to financially report the asset. However, IFS did not use the controlling entity's information to automatically populate that indicator. As a result, IFS did not send DCD/DCW correct information for determining the controlling entity and reporting on the appropriate financial statements. For example, the Tobyhanna Army Depot's Forward Repair Activity, an AWCF entity, was the preponderant user of a building at Fort Hood, Texas. When the RPAO entered the acquisition cost (\$269,046) of the building in the IFS database, IFS populated the indicator as AGF. To comply with GAAP, the Army should have transferred control of the asset or recorded an imputed financing source.

Conclusion

The OUSD(C)/CFO should rescind the DoD preponderance-of-use policy and establish new business rules defining the requirements for implementing a real property reporting and costing methodology that fully complies with GAAP. DoD must be able to determine the proper controlling entity for each real property asset and ensure that the entity reports each asset in its financial statements. The

controlling entity needs to identify the users of its assets and either bill the associated costs or notify the users of the costs incurred on their behalf. The user should either reimburse the controlling entity or record an imputed cost and an imputed financing source for the benefit received.

The Army should not expend resources to develop an IFS system change to correct identified problems. Instead, it should work with the OUSD(C)/CFO to establish a policy that complies with GAAP and distributes costs to the users of real property assets either directly or through the use of imputed financing. Once developed, the Army needs to train its RPAOs and financial managers on business rules established to comply with GAAP and monitor user compliance with the new real property costing methodology.

Recommendations, Management Comments, and Audit Response

A.1. We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer rescind the DoD preponderance-of-use policy and establish business rules for implementing a real property costing methodology that complies with Statement of Federal Financial Accounting Standards No. 4. Specifically:

- a. Require Military Departments to report on their General Fund financial statements all real property assets constructed using their appropriated funds.**
- b. Direct the Military Departments to notify users of the costs incurred for their use of DoD real property assets, and direct the users to either reimburse the Military Department for their use of the asset or record any unreimbursed portion as an imputed cost from an imputed financing source.**

Under Secretary of Defense (Comptroller) Comments. The Deputy Chief Financial Officer partially concurred and stated that by September 30, 2008, his office would update the DoD FMR with new business rules for defining financial control over real property assets and implementing an imputed costing methodology that complies with SSFAS No. 4. He also stated that scenarios for real property reporting and imputed costs would be developed and added to the DoD FMR. However, he stated that these actions would not constitute the rescission of policy.

Audit Response. The Deputy Chief Financial Officer's comments are responsive. The policy contained in DoD FMR, volume 4, chapter 6, does not comply with the requirements of SSFAS No. 4. The OUSD(C)/CFO plans to establish business rules to instruct DoD Components on how to determine which entity has financial control over real property assets and should report the assets on its financial statements in compliance with SFFAS No. 4. Development of

these business rules will require a substantial change to the guidance in the DoD FMR. We do not require additional comments on the final report, but we will closely monitor policy changes during the audit followup process.

Army Comments. Although not required to comment, the Deputy Assistant Secretary of the Army (Financial Operations) stated that the Army will establish business rules to implement the imputed costing methodology issued by the OUSD(C)/CFO.

A.2. We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller):

a. Identify the facilities located at the 13 Army Working Capital Fund installations funded by the Army General Fund and report them on the Army General Fund financial statements.

b. Train installation financial managers and Real Property Accountability Officers and then ensure that they comply with the business rules that the Under Secretary of Defense (Comptroller)/Chief Financial Officer establishes for implementing a real property costing methodology.

Army Comments. The Deputy Assistant Secretary of the Army (Financial Operations) concurred and stated that his office would work with ACSIM to record facilities on the correct financial statements. They will also jointly work to train real property personnel on the costing methodology issued by the OUSD(C)/CFO and seek training opportunities within the financial and real property communities.

B. Subsidiary Ledger File Supporting Army Real Property Transactions

The Army did not implement a common business process for creating a subsidiary ledger file to support the property management and financial reporting of AWCF and AGF real property assets. The Army modified IFS to expand capabilities for AGF installations, but it did not implement similar capabilities for AWCF installations because they were already using DPAS to:

- calculate depreciation on real property assets that met capitalization requirements,
- maintain the real property financial transactions, and
- report the financial transactions to the accounting systems.

Maintaining two different business processes was inefficient and resulted in inaccurate and incomplete real property data in subsidiary ledger files.

Subsidiary Ledger File

Historically, the Army has used a variety of data calls and other methods to report real property data on its financial statements. ACSIM and the ASA(FM&C) initially attempted to use DPAS to compute depreciation and perform financial reporting of all AWCF and AGF real property. IFS recorded the source data and passed the data to DPAS using a system interface. In Report No. AA 01-358, “Audit of the Integrated Facilities System for Financial Management System Compliance,” June 28, 2001, the U.S. Army Audit Agency determined that IFS did not substantially comply with the Federal Financial Management Improvement Act because the system did not provide sufficient audit trails, use required data elements, or comply with all financial management system requirements. However, the U.S. Army Audit Agency reported that the IFS interface with DPAS had compensated for several of the financial management system requirements. In addition, the U.S. Army Audit Agency recognized that IFS was the source of the real property financial data, and IFS must have the capability to maintain proper audit trails.

In May 2003, the Office of the Secretary of Defense approved the Army’s request to modify IFS functionality to allow the system to calculate depreciation and run financial reports directly from each installation’s database so that the IFS system interface with DPAS would no longer be used. The Army reported in its FY 2004 Annual Statement of Assurance that the IFS interface with DPAS did not ensure accurate reporting of real property on the Army financial statements and that the approved changes to IFS would correct the material weakness. In July 2005, the Army implemented IFS System Change Package 16 to make IFS the source of real property subsidiary data and make it compliant with the Federal Financial Management Improvement Act.

DoD FMR, volume 6A, “Reporting Policy and Procedures,” chapter 2, “Financial Reports Roles and Responsibilities,” March 2002, requires DoD Components to reconcile subsidiary ledger files to the financial balances. The subsidiary ledger file produces transaction data needed for the general ledger. The transaction amounts from the subsidiary ledger file must be reconcilable to the financial statements by general ledger account code (GLAC). The subsidiary ledger file should identify each real property asset’s location, quantity, acquisition date, cost, useful life, and other information.

Federal Financial Management Systems Requirements, “Property Management Systems Requirements,” October 2000, requires real property systems to record beginning balances, acquisitions, withdrawals, and ending balances. For capitalized real property, the systems must classify assets by asset type, record acquisition costs and useful lives, and be able to calculate depreciation. (Finding C discusses the need for DoD accounting systems to send the acquisition costs to IFS.)

Common Transaction Processing

ACSIM and ASA(FM&C) did not develop a common business process to create a subsidiary ledger file of real property data that supports the amounts reported in the AWCF and AGF financial statements. Although the Army required similar information to support amounts reported on its AWCF financial statements, ACSIM did not implement all of the System Change Package 16 changes within the 13 AWCF databases. Specifically, the AWCF databases:

- did not calculate depreciation;
- did not record auditable capitalization and depreciation related accounting information; and
- did not report acquisition, improvement, and disposition transactions to the Army financial statements through the DCD/DCW.⁸

Instead, the Army used the information from IFS as the AGF subsidiary ledger file, but it required the information from both IFS and DPAS to produce the AWCF subsidiary ledger file. ACSIM continued to use DPAS to depreciate and report AWCF real property assets because DPAS had the capability to send financial data directly to the AWCF accounting systems in support of installation-level financial reporting. However, both IFS and DPAS contained inaccurate real property data, and neither system had complete AWCF subsidiary ledger files. As a result, the Army did not have a central repository for AWCF and AGF real property subsidiary data, and it was inefficient and costly to maintain two different business processes. In addition, ACSIM created a system control weakness by designing an IFS interface with DPAS that created the opportunity for some tenants at Army installations to bypass IFS system controls.

⁸ DCD/DCW is part of the information system known as Business Enterprise Information Services.

Accuracy and Completeness of Real Property Data

The Army did not have an accurate and complete subsidiary ledger file for AWCF real property assets. Real property personnel did not always enter real property assets in IFS and routinely send the records to DPAS for depreciation and financial reporting. Furthermore, real property personnel and resource managers did not reconcile their data to ensure that the subsidiary ledger files supported the GLAC totals in the accounting systems (SIFS and LMP). Our review of five AWCF installations revealed that:

- real property personnel did not ensure that IFS routinely sent complete and accurate data to DPAS,
- DPAS did not return timely data to IFS,
- reconciliations between subsidiary ledger files and information in accounting systems were inadequate and inefficient, and
- DPAS users could bypass IFS system controls and update property management records.

As a result, neither IFS nor DPAS served as an accurate and complete subsidiary ledger file to support the values reported on the AWCF financial statements.

Completeness of DPAS Data. AWCF real property personnel did not routinely keep DPAS updated with current and complete real property records. On a daily basis, real property personnel entered new and updated real property records in the “DPAS window” in IFS for assets meeting the capitalization threshold. At least once a month, they sent an IFS real property file to DPAS as part of the IFS system interface with DPAS. However, one of the five installations visited did not send all appropriate real property records from IFS to DPAS. Another installation did not use either IFS or DPAS as its subsidiary ledger file.

- The RPAO at Corpus Christi Army Depot, Texas, did not understand how to populate the “DPAS window” in IFS. Consequently, IFS did not send the costs for two buildings placed in service in March 2004 to DPAS. As a result, the AWCF understated the acquisition cost reported in the AWCF financial statements by \$1.4 million.
- Crane Army Ammunition Activity, Indiana, did not use IFS to account for its real property. Instead, they used a flawed manual method to record real property assets and calculate depreciation. Since FY 2002, this organization has manually sent \$96 million in real property acquisition costs and \$77.8 million in accumulated depreciation directly to SIFS, bypassing DPAS. As a result, neither DPAS nor IFS maintained subsidiary data for this installation.

Timeliness of DPAS Data Updates. ACSIM did not establish a specific cutoff date for installations to send new and updated capitalization records from IFS to

DPAS for depreciation purposes.⁹ Either ACSIM systems personnel or a local installation database administrator initiated the IFS system interface with DPAS. ACSIM systems personnel ran the IFS system interface with DPAS twice a week for four AWCF installations and upon request for another AWCF installation. At the other seven AWCF installations that used DPAS, the local database administrators determined the date to run the IFS system interface. By allowing installations to determine when to run the IFS system interface, installations updated DPAS and retrieved depreciation amounts on different dates. If systems personnel do not run the IFS system interface with DPAS by a certain time each month, DPAS may not have the most recent additions, improvements, and deletions of real property assets for use when calculating monthly depreciation. As a result, ACSIM cannot ensure that installations have reported the appropriate accumulated depreciation balances during the accounting period and that the subsidiary data contained in IFS will agree with the accounting systems. As of September 30, 2006, the IFS database for Anniston Army Depot listed an accumulated depreciation balance that was \$992,060 less than what DPAS had reported for use in the AWCF financial statements. The difference was caused by IFS not updating the depreciation amounts for 350 real property assets until the installation ran the interface update cycle with DPAS. Because not all installations ran the cycle at least monthly, this discrepancy could actually be greater. For example, the accumulated depreciation recorded in IFS and DPAS for several of the assets at Tobyhanna Army Depot differed by 2 months.

Accumulated Depreciation Totals. IFS did not contain accurate accumulated depreciation balances because DPAS did not always update IFS after adjusting depreciation amounts. Our comparison of DPAS and IFS files for the 13 AWCF installations identified 174 real property records that had an accumulated depreciation balance of \$0 in DPAS, but which had an accumulated depreciation balance in of \$66.5 million in IFS as of September 30, 2006. Over time, as real property personnel realized that they had erroneously capitalized repair costs or assigned costs to the wrong facility, they removed the acquisition costs of 174 records from IFS. IFS then passed the correction to DPAS, which subsequently removed the corresponding accumulated depreciation. However, DPAS did not return an updated record to IFS indicating the \$0 accumulated depreciation amount. Because IFS did not send the 174 records to DPAS (because IFS had reduced the asset's acquisition costs to \$0 and dropped it below the capitalization threshold), the records were not part of the reconciliations between IFS and DPAS. As a result, managers did not identify the discrepancies, and the subsidiary files in IFS did not match the financial balances in DPAS.

Reconciling Real Property Data. Reconciliations between the subsidiary ledger files and information in the AWCF accounting systems were inadequate and inefficient. Each month, DPAS sent reconciliation reports to installation personnel indicating discrepancies between IFS and DPAS data. However, installation personnel at three of the five installations visited did not reconcile the IFS and DPAS data. In addition, installation personnel conducted monthly reconciliations between the general ledger data recorded in DPAS with the GLAC totals recorded in SIFS and LMP. However, neither of the reconciliations was sufficient to identify differences such as the accumulated depreciation errors in

⁹ Capitalization records are the real property transactions created by IFS.

IFS and the records not in DPAS. In addition, performing two reconciliations was inefficient. Removing DPAS from the business process will reduce the need for multiple reconciliations and will increase the accuracy of IFS as a subsidiary ledger file.

System Controls over Real Property Data Entry. One of the files in the IFS interface with DPAS had the capability to bypass IFS system controls established to ensure the accuracy of real property data. Some tenants on Army installations had DPAS access that allowed them to enter improvement records into DPAS, which IFS used to update the real property database. This process bypassed established controls designed to ensure that RPAOs review and support all real property updates in IFS. Although our review of the IFS files did not indicate that the AWCF installations had used this DPAS interface since 1999, the interface file was still available for use and circumvented IFS system controls. The removal of DPAS from the business process will allow ACSIM to eliminate the unnecessary risk introduced by the ability of DPAS to update IFS improvement records.

Complete Army Real Property Database

The Army has not developed a central repository to consolidate the subsidiary data that supports the value of real property assets reported on AWCF financial statements. However, the Army has developed a real property initiative to use DCD/DCW as the central repository for all real property financial transactions until it can finish fielding LMP and develop and deploy the General Fund Enterprise Business Systems (GFEBS) for AGF accounting. System Change Package 16 implemented the capability for IFS to send real property subsidiary data to DCD/DCW. IFS began to send the data from the 147 AGF databases to DCD/DCW in September 2006.

DFAS plans to use AGF information from DCD/DCW to generate trial balances for departmental reporting and provide Army managers with information to make informed decisions. ACSIM expected DPAS to send similar data from the 13 AWCF databases to DCD/DCW. However, DPAS system managers did not send the data to DCD/DCW because they believed that ACSIM was sending the AWCF real property financial transactions to DCD/DCW.

The Army should standardize the business process for financial reporting of all AWCF and AGF real property assets. By reconciling and sending all AWCF and AGF real property financial transactions to DCD/DCW, the Army could establish a consistent interim method of supporting the real property values reported on its financial statements. In addition, AWCF entities could then retrieve from DCD/DCW any real property financial transactions needed to support installation financial reporting requirements. Once this occurs, the Army can terminate the use of DPAS as a real property management system. In the long term, the Army must integrate IFS with GFEBS and LMP in order to report real property information at the installation level. In the interim, ACSIM should send AWCF real property information to DCD/DCW.

Conclusion

The Army has not implemented a common business process to collect and report AWCF and AGF real property asset transactions. Instead, the Army implemented different processes for depreciating and reporting AWCF and AGF real property assets. Neither DPAS nor IFS contained accurate subsidiary ledger data that fully supported the values the Army reported for real property on its FY 2006 AWCF and AGF Financial Statements. The Army needs to use IFS to calculate depreciation, maintain subsidiary ledger files, and report financial information on both AWCF and AGF real property assets. The Army would eliminate the problems with maintaining accurate and complete information in DPAS if it terminated the system interface between IFS and DPAS and used IFS to calculate depreciation and report financial information for AWCF real property assets. However, the Army still needs to:

- establish a standard cutoff date for updating capitalization records and calculating depreciation;
- perform a comprehensive reconciliation among IFS, DPAS, and the accounting systems real property data to ensure that the subsidiary records are accurate and complete; and
- conduct recurring reconciliations between subsidiary ledger files in IFS and information reported to AWCF accounting systems.

Standardizing the business process will help to ensure that Army installations maintain accurate and complete real property subsidiary files that support the values reported on the financial statements and allow the Army to better use available resources. ACSIM, in conjunction with DFAS, should use DCD/DCW to collect and report all Army-managed real property data until the Army can develop a standard business process that integrates the subsidiary ledger information in IFS with the Army's two new accounting systems (GFEBS and LMP).

Recommendations, Management Comments, and Audit Response

B.1. We recommend that the U.S. Army Assistant Chief of Staff for Installation Management, Assistant Secretary of the Army (Financial Management and Comptroller), and Deputy Director for Operations, Defense Finance and Accounting Service, develop an interim business process for financially reporting Army General Fund and Army Working Capital Fund real property assets. Specifically, the Army and Defense Finance and Accounting Service should:

a. Use the Defense Finance and Accounting Service Corporate Database/Defense Finance and Accounting Service Corporate Warehouse as the subsidiary ledger file for Army-managed real property assets.

- b. Establish a monthly cutoff date for updating capitalization records, calculating depreciation, and recording the applicable financial transactions to the appropriate trial balances that support the values reported on the Army financial statements.
 - c. Develop a process for Army Working Capital Fund entities to retrieve from the Defense Finance and Accounting Service Corporate Database/Defense Finance and Accounting Service Corporate Warehouse all real property financial transactions needed to support installation financial reporting requirements.
 - d. Perform a comprehensive reconciliation among the Integrated Facilities System, Defense Property Accountability System, and the accounting systems real property data to ensure that subsidiary records are accurate and complete.
 - e. Require resource managers to periodically conduct reconciliations between the subsidiary ledger files in the Integrated Facilities System and information in the Army Working Capital Fund accounting systems.
 - f. Upon full implementation of Recommendation B.1.c.:
 - (1) Establish in the Army Working Capital Fund Integrated Facilities System databases the ability to calculate depreciation on a specific cutoff date, maintain subsidiary ledger files, and update the Defense Finance and Accounting Service Corporate Database/Defense Finance and Accounting Service Corporate Warehouse with all real property data.
 - (2) Terminate the system interface between the Integrated Facilities System and the Defense Property Accountability System and discontinue using the Defense Property Accountability System for reporting Army Working Capital Fund real property assets.

Army Comments. The Deputy Assistant Secretary of the Army (Financial Operations), responding for ASA(FM&C) and ACSIM, partially concurred and stated that uniform processing and reconciliation of AWCF real property assets are part of the ongoing business transformation efforts and conversion to GFEBS. He also stated that if a substantial delay in implementing GFEBS occurred, the Army would incorporate interim business processes, such as DCD/DCW.

Defense Finance and Accounting Service Comments. The DFAS Director for Indianapolis Operations nonconcurred and stated that we should redirect the recommendation to the Business Transformation Agency. He stated that systems development and initiatives, including DCD/DCW, were transferred to the Business Transformation Agency in FY 2008.

Audit Response. The Army and DFAS comments are partially responsive. The Army must improve existing processes for ensuring accurate subsidiary ledger data. This recommendation also presents an interim solution for the Army to improve the reporting of its real property assets until the Army fully implements

GFEBS in FY 2011. We believe that the Army unnecessarily maintains two distinct processes for reporting its real property assets that causes inconsistent and inaccurate financial reporting of real property assets.

The Army has spent approximately \$865,000 to develop the real property initiative within DCD/DCW intended to standardize the processes for reporting AWCF and AGF real property data. Both the Army and DFAS have responsibility for using the data that DCD/DCW can provide to support installation financial reporting requirements and the values reported on the AWCF and AGF financial statements. The use of DCD/DCW as a near-term solution would ease the transition to GFEBS and permit the Army to reconcile its real property to the proper financial statements, uniformly depreciate its real property assets, and develop financial statements with more accurate data. If the Army does not use DCD/DCW, it still should establish uniform cutoff dates for depreciation calculations; perform comprehensive reconciliations of real property databases; and require periodic reconciliations of subsidiary ledger files to ensure accuracy of current-year financial statements and effective implementation of GFEBS. We request that the Army and DFAS reconsider their positions and provide additional comments on the final report that address the need to improve existing processes for ensuring accurate subsidiary ledger data and the use of DCD/DCW as an interim solution until the Army implements GFEBS.

B.2. We recommend that the U.S. Army Assistant Chief of Staff for Installation Management, in conjunction with the U.S. Army Program Executive Officer, Enterprise Information Systems, develop plans to integrate the Integrated Facilities System with the Logistics Modernization Program system and the General Fund Enterprise Business System so that the capability exists to generate a subsidiary ledger file at the installation level that supports the Army General Fund and Army Working Capital Fund financial statements.

Army Comments. The Deputy Assistant Secretary of the Army (Financial Operations), responding for ACSIM, partially concurred and stated that the Army plans for GFEBS to subsume IFS, making integration between IFS and GFEBS unnecessary. In the meantime, the Army will continue to use IFS and DPAS to calculate and report depreciation for AWCF real property assets.

Audit Response. The Army comments are partially responsive. We agree that the integration of IFS with GFEBS is unnecessary, based on the Army's recent decision to subsume all real property accountability and accounting functions into GFEBS. However, a requirement still exists to develop the appropriate system integration needed between GFEBS and LMP to provide the LMP system with the subsidiary ledger data it needs to support the real property values reported on the AWCF installation trial balances. We addressed the need for the Army to discontinue using DPAS for reporting AWCF real property assets in Recommendation B.1. We request that the Army reconsider its position and provide additional comments, in coordination with the Program Executive Officer, Enterprise Information Systems, on the final report. The Army should explain its plans and timeline to integrate GFEBS with LMP to provide the financial information needed for AWCF installations to correctly report AWCF real property assets.

C. Reliability of Acquisition Costs

The Army did not accurately or efficiently transfer construction-in-progress (CIP) costs between accounting and property management systems. Specifically, the Army did not:

- transfer CIP costs recorded in the general ledger accounts of the construction agent to the accounting system of the entity that placed the constructed asset in service,
- use the CIP costs reported in the AWCF accounting systems to record the acquisition cost of real property assets in IFS and the general ledger asset accounts, and
- record consistent accounting entries when placing an asset in service.

CIP costs were not properly transferred because the Army used a manual data entry process that was flawed to record the acquisition cost of its real property assets. As a result, Army resource managers could not ensure the accuracy and completeness of the acquisition costs of AWCF and AGF real property assets. In addition, the Army unnecessarily expended resources by performing duplicate data entry in the property management and accounting systems.

Reliability of the Cost of Real Property

Financial Reporting. Reliable financial reporting of real property assets requires that accounting and real property management systems share information and that financial and real property managers cooperate with each other. Office of Management and Budget Circular No. A-127 requires the one-time entry of cost data and the subsequent transfer of that data between systems as needed. The acquisition cost, which includes all costs incurred to bring an asset to a form and location suitable for its intended use, is an important data element for the proper financial reporting of real property assets.

Reporting Acquisition Costs of Constructed Assets. DoD managers recognized the need to improve their ability to accurately capture and report the full acquisition costs of constructed assets. In October 2006, the Deputy Under Secretary of Defense (Installations and Environment) (DUSD[I&E]) identified DoD requirements for implementing a more efficient CIP process in its “Construction-in-Progress Requirements” document. The document recognized that DoD entities construct assets using a variety of methods and required specific parties to maintain the CIP account. New construction, using either a DoD construction agent or installation construction personnel, is one of the Army’s

major acquisition methods for real property assets.¹⁰ Depending on which DoD entity funds an asset's construction, either the construction agent or the entity receiving the asset must accumulate the construction costs in its accounting system by project number, using a CIP account.

To comply with Office of Management and Budget Circular No. A-127, Army accounting systems should have the ability to maintain a complete CIP account and automatically transfer costs accumulated in the CIP accounts to the appropriate GLAC accounts in the receiving installation's accounting system. The accounting system should then be able to populate the acquisition value within the property management system when placing an asset in service. This process would strengthen audit trails and reduce the risk of error caused by manual intervention.

Requirements for Recording CIP. DoD FMR, volume 4, chapter 6, provides guidance on how to account for and report CIP costs when DoD entities construct real property assets. CIP represents the internal and external costs associated with the project design, site preparation, and actual construction of a real property asset. Upon construction completion, if the CIP costs equal or exceed the DoD capitalization threshold, the entity is to transfer the CIP costs to the appropriate real property GLAC as the acquisition cost of a real property. To help determine whether the asset meets the DoD capitalization threshold, DoD entities should capture and accumulate CIP costs by individual real property asset. The DoD FMR requires DoD construction agents to accumulate costs for any constructed asset that will meet the capitalization threshold in a CIP account.¹¹ The DoD FMR requires the DoD entity that receives the constructed assets to report the CIP amounts on its financial statements.

Maintaining a Complete CIP Account

The Army did not transfer CIP costs from construction agents to the AWCF installations that received the real property assets and failed to report CIP costs maintained by construction agents on the AWCF financial statements. For locally constructed assets, the AWCF accounting systems did not track all appropriate CIP costs by project number and unique asset identifier. The Army must maintain accurate and complete CIP balances to ensure the proper recording of real property assets on its financial statements.

Recording of CIP Costs by a Construction Agent. The Army did not have the system functionality to transfer the CIP balance recorded in the U.S. Army Corps of Engineers (USACE) accounting system to the appropriate receiving entity's accounting system. In addition, the Army erroneously reported all CIP costs accumulated by USACE on the AGF financial statements. USACE was the

¹⁰ The major DoD construction agents are USACE and the Naval Facilities Engineering Command. Other approved DoD organizations also serve as DoD construction agents. USACE was the only construction agent to report CIP costs to DFAS for the Army.

¹¹ On March 13, 2006, DoD lowered the capitalization threshold from \$100,000 to \$20,000. The Army still uses the \$100,000 capitalization threshold.

primary construction agent used on Army installations. When USACE built Army real property assets on a non reimbursable basis, Army managers provided USACE with the authority to cite an Army appropriation directly to pay for the construction of the asset. During construction, USACE accumulated costs associated with construction in CIP accounts recorded in its accounting system, the Corps of Engineers Financial Management System. The CIP accounts tracked the costs incurred by project number and associated real property identifiers. On a quarterly basis, USACE provided the DFAS Departmental Accounting Branch with the amounts recorded in the Corps of Engineers Financial Management System CIP accounts that cited specific Army appropriations. DFAS personnel used this information to prepare journal vouchers that transferred the CIP costs to the AGF financial statements.

Installation Reporting. Transferring the CIP costs at the departmental level prevented installations from maintaining a complete and accurate record of real property costs. As a result, installation resource managers could not monitor and report these CIP amounts on their trial balance and did not have the information required to verify the acquisition costs when they placed the assets in service. USACE should have sent the costs recorded in its CIP accounts to the appropriate receiving entity's accounting system. This would have provided a complete CIP balance for financial reporting and expedited asset transfer to the proper general ledger account upon acceptance. We recognize that developing this functionality in legacy systems is not cost-effective. However, as the Army develops and implements the Logistics Modernization Program (LMP) system and the General Fund Enterprise Business System (GFEBS), it should integrate systems functionality for installations to be able to receive CIP costs directly from any construction agent's accounting system.

Departmental Reporting. The Army underreported CIP costs for assets constructed by USACE for AWCF entities. As discussed in Finding A, the DoD FMR preponderance-of-use policy required the preponderant user of an asset to report the acquisition amounts on its financial statements. Similarly, AWCF entities should have reported CIP costs associated with assets under construction for their use. The Army and DFAS incorrectly reported the CIP costs provided by USACE on the AGF financial statements, regardless of which Army entity received the assets. DFAS assumed that AGF should report the CIP costs because USACE used Army-appropriated funds to construct the assets. The Army did not inform DFAS of the CIP costs that DFAS should have reported on the AWCF financial statements. As of March 30, 2007, USACE had accumulated \$13.4 million in CIP costs for construction projects at the five AWCF installations we visited. However, the DFAS Departmental Accounting Branch inappropriately reported the \$13.4 million on the second quarter FY 2007 AGF financial statements, instead of on the AWCF financial statements. The Army may also have underreported the CIP costs accumulated by USACE for AWCF construction projects at the remaining eight AWCF installations. As we said in Finding A, the current DoD preponderance-of-use policy does not comply with SFFAS No. 4.¹² However, until DoD rescinds the preponderance-of-use policy,

¹² If DoD implements Recommendation A.1., then DFAS would be correct in reporting the \$13.4 million in CIP costs on the AGF financial statements because the Army uses its appropriated funds to fund the construction. The AWCF entities would only report CIP costs funded using AWCF funding.

ASA(FM&C), with support from DFAS, should develop a method to transfer the CIP costs accumulated by USACE to the receiving installation so that it can report the CIP value in the AWCF financial statements. Upon integration of the Army accounting systems, DFAS will no longer need to transfer the costs.

Recording of CIP Costs by Army Installations. Army accounting systems did not record all CIP costs by project number and unique asset identifier when an Army installation used its local public works personnel to construct real property assets. According to the DoD FMR, volume 4, chapter 6, local resource managers should establish a CIP account in their accounting systems by project number and unique asset identifier to track all costs associated with construction. The accounting system should report these costs in the Construction-in-Progress account (GLAC 1720), until the installation places the asset in service.

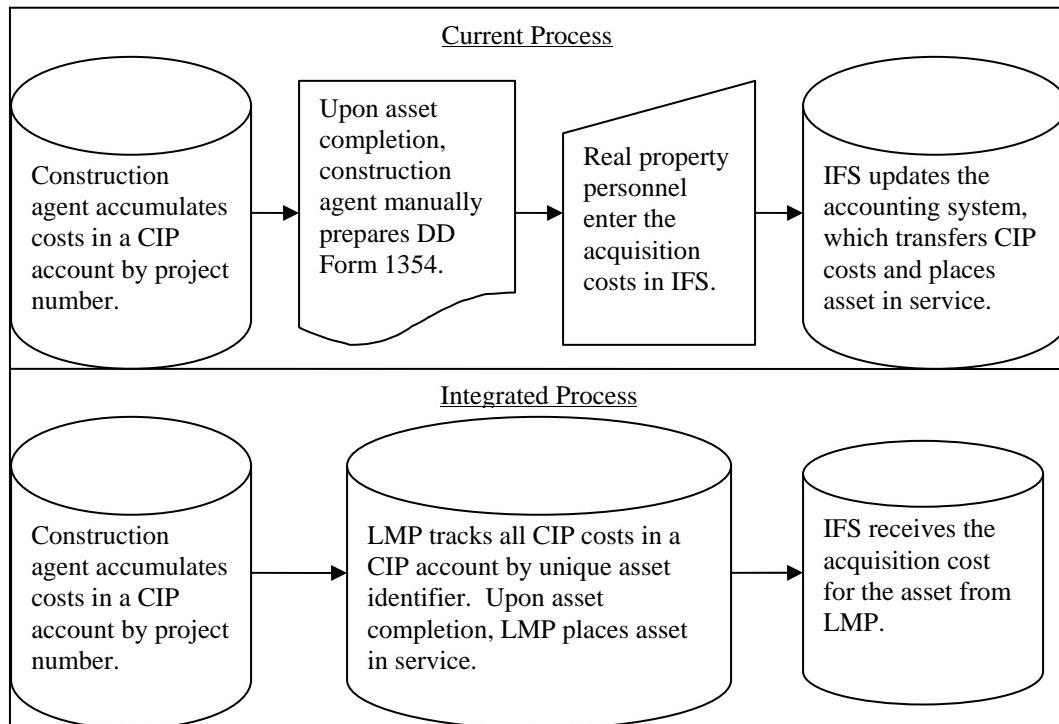
Standard Industrial Fund System. SIFS did not track CIP costs by project number and unique asset identifier. However, because the Standard Industrial Fund System (SIFS) is a legacy system and the Army is fielding LMP as its replacement, it would not be cost-effective to correct this problem in SIFS. Therefore, developing system functionality to correct the problem must occur as installations transfer to LMP.

Logistics Modernization Program. LMP accumulated contract-related and other external construction costs in a CIP account by project in an Asset Under Construction record, but it did not record any internal costs, as required by the DoD FMR. The system posted daily disbursements made on purchase orders to the Operating Expense/Program Cost account (GLAC 6100). The purchase orders assigned the costs to specific capital spending projects or reported them as expenses. Daily, LMP transferred any costs recorded in GLAC 6100 assigned to a capital spending project to the Construction-in-Progress Buildings account (GLAC 1720.51). However, LMP did not identify and transfer internal costs, such as labor, incurred on capital spending projects. As a result, the CIP account did not contain all asset construction costs. As the Army develops and implements LMP and GFEBS, it should develop and implement the functionality to identify and track—at the project level—all internal costs related to asset construction. It should also develop functionality to post the costs to the appropriate CIP account so that complete and accurate acquisition-cost information is available for making capitalization decisions and financial reporting.

Establishing Acquisition Costs

Neither LMP nor SIFS had the capability to transfer the CIP balance recorded in the accounting system to the Integrated Facilities System (IFS) when placing an asset in service and establishing acquisition costs in IFS. Instead, installation Real Property Accountability Officers (RPAOs) manually entered the acquisition cost in IFS based on an amount recorded on the DD Form 1354, “Transfer and Acceptance of Military Real Property” (prepared by the construction agent) and then transferred this data to the accounting system when placing the asset in service. This process unnecessarily expended resources to duplicate the data

entry of acquisition costs and did not ensure that the Army maintained an adequate audit trail to trace the recorded acquisition cost to the original cost data recorded in the CIP accounts. Upon acceptance of an asset, the resource manager should have updated the accounting system, by transferring the amount to the GLAC associated with the type of asset constructed, and then recorded the acquisition cost in the property management system, IFS. The following figure shows how the current process for transferring CIP costs from USACE compares to an integrated process that sends costs through LMP to IFS.



Comparison of Process for Transferring CIP Costs from USACE

By sending acquisition costs directly from the accounting systems to IFS, the Army would eliminate duplicate data entry—thus strengthening controls—because the RPAO would no longer manually enter the costs from the DD Form 1354 into IFS. The costs would readily trace to the source document, such as a purchase order, already recorded in the accounting system. In addition, this process would ensure proper separation of duties because resource managers, instead of real property personnel, would initiate the recording of the cost information that updates the financial records. We will address separation of duties more fully as part of our second report.

Logistics Modernization Program

Although LMP could track CIP costs in an Asset Under Construction account, the system only used this account to manage costs incurred by local real property personnel. The system did not track CIP costs incurred by construction agents in the Asset Under Construction account. Further, LMP did not use the CIP costs to

establish the acquisition costs in IFS. Instead, real property personnel manually entered the costs into IFS based on DD Form 1354. IFS then sent the costs to DPAS, which created a financial transaction to debit the real property asset accounts (GLAC 1730 or 1740) and credit the CIP subaccount (GLAC 1720.9990). When the accounting system posted the final payment, LMP reconciled the CIP account by clearing the balances in GLAC 1720.51 and GLAC 1720.9990. Had construction agents transferred CIP costs to LMP, the system would contain a complete record of CIP costs associated with an asset in the appropriate Asset Under Construction account. Once the entity placed the asset in service, LMP should have transferred the asset balance from the Asset Under Construction account to the appropriate GLAC and populated the asset's acquisition cost in IFS. ACSIM should develop the functionality in IFS to use the costs accumulated in the Asset Under Construction account as the asset's acquisition cost whenever an AWCF installation places an asset in service. However, until that time the Army should allow only installation resource managers to record acquisition costs within IFS based on the CIP costs recorded in the accounting systems, including internal costs and costs incurred by construction agents. This separation of duties would ensure the proper recording of accounting transactions.

Standard Industrial Fund System

SIFS could not transfer CIP costs to IFS because the system did not accumulate CIP costs by unique asset identifier. Until the Army replaces SIFS with LMP, resource managers should enter project costs into IFS when placing an asset in service. Furthermore, SIFS did not record the appropriate offsetting journal vouchers to ensure the correct transfer of acquisition costs and the proper elimination of inter-entity transactions at the DoD-wide level. SIFS erroneously recorded an asset transferred in from others in the Unexpended Appropriation account (GLAC 3100.20), instead of recording the transfer in the Financing Sources Transferred In Without Reimbursement account (GLAC 5720). SIFS used the financial transaction accounting code established by DPAS to determine which GLACs to debit and credit when transferring real property assets.

When USACE transferred fully constructed real property assets to the Army, USACE recorded an accounting entry in its accounting system that debited the CIP - Contractor account (GLAC 1720.12) and credited the Financing Services Transferred Out Without Reimbursement – Non-Corps account (GLAC 5730.13). To offset this transaction, SIFS accounting personnel should have debited the Buildings, Improvements, and Renovations account (GLAC 1730) or Other Structures and Facilities account (GLAC 1740) and credited GLAC 5720. Instead, SIFS entities credited GLAC 3100.20.

The DoD FMR, volume 11B, “Reimbursable Operations, Policy, and Procedures – Working Capital Funds,” chapter 58, “Capital Assets,” December 1994, requires DoD entities to credit the Transfers In from Others Without Reimbursement account (GLAC 3220). However, the DoD FMR does not comply with the Treasury Department’s “U.S. General Standard Ledger Supplemental No. S2 Treasury Financial Manual,” July 2006, which states that entities must use GLAC 5720 to record an increase in the financing source when

an asset transfers in from others. The OUSD(C)/CFO should revise the DoD FMR to comply with the Department of Treasury's guidance. DFAS and Army financial managers must ensure that DPAS and SIFS appropriately record the cost of assets transferred in from USACE in GLAC 5720 to ensure that the AWCF financial statements are accurate and identify all of the inter-entity transactions for elimination in the DoD financial statements.

Conclusion

The AWCF did not identify accurate and complete CIP balances for all of its real property assets. Instead, the Army erroneously reported AWCF CIP costs on the AGF financial statements. The Army should automatically transfer CIP costs from the construction agent's accounting system to the receiving entity's accounting system. In addition, the ASA(FM&C), in coordination with the Army Program Executive Officer, Enterprise Information Systems, should develop the functionality in LMP to receive CIP costs from the construction agent's accounting system. LMP must also accumulate all internal costs associated with the construction of an asset to provide a complete CIP balance. LMP could then transfer the total balance in the CIP account to the appropriate asset account within LMP and to IFS for use as the asset's acquisition cost when placing the asset in service. This functionality should also be a system requirement for GFEBS.

SIFS, an AWCF legacy accounting system, did not track CIP costs by project number and unique asset identifier. Instead of correcting this problem in a legacy system, Army resource managers should obtain the CIP balance from construction agents and enter the total acquisition costs in IFS when placing assets in service. In addition, SIFS did not post the appropriate accounting transactions in accordance with the Treasury Department's U.S. Government Standard General Ledger posting rules when another entity transferred assets to it. SIFS erroneously credited the Unexpended Appropriations account, instead of crediting the Transfers-in Without Reimbursement account. Army financial managers must use the Transfers-in Without Reimbursement and Transfers-out Without Reimbursement accounts when receiving real property from a construction agent to ensure the proper elimination of transactions.

Recommendations, Management Comments, and Audit Response

Revised Recommendation. As a result of management comments, we revised draft Recommendation C.4. to establish ASA(FM&C) as having the lead role in developing a method for transferring CIP costs to the appropriate AWCF installations.

C.1. We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer update the DoD Financial Management Regulation, volume 11B, "Reimbursable Operations, Policy,

and Procedures – Working Capital Funds,” chapter 58, “Capital Assets,” to require DoD entities to record transfers-in of assets in general ledger accounting code 5720, “Financing Sources Transferred In Without Reimbursement.”

Under Secretary of Defense (Comptroller) Comments. The Deputy Chief Financial Officer concurred and stated that his office would update the DoD FMR, volume 11B, chapter 58, by September 30, 2008.

C.2. We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller), in conjunction with the Army Program Executive Officer, Enterprise Information Systems, develop within the Logistics Modernization Program and General Fund Enterprise Business Systems, an integrated process to:

- a. Receive construction costs directly from any construction agent’s accounting system.**
- b. Record internal costs incurred in the construction of a capital asset to the corresponding project’s Construction-in-Progress account.**

Army Comments. The Deputy Assistant Secretary of the Army (Financial Operations) concurred and stated that the Army will include processes for recording CIP costs as part of the transformation to GFEBS. In the interim, the Army will use the Headquarters Installation Information System to record and send construction costs to the appropriate entity for financial reporting.

C.3. We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller), in conjunction with the Army’s Assistant Chief of Staff for Installation Management, develop and implement a process to establish an asset’s acquisition cost based on the costs previously accumulated in the accounting systems’ Construction-in-Progress accounts. Specifically:

- a. Develop the functionality in the Integrated Facilities System to use the costs accumulated in the Logistics Modernization Program system’s Asset Under Construction accounts as the asset’s acquisition cost whenever an Army Working Capital Fund installation places an asset in service.**
- b. Require resource managers to manually enter acquisition costs, including any internal costs, in the Integrated Facilities System based on the journal vouchers received from construction agents when placing an asset in service. The Army should maintain this process until the Logistics Modernization Program system has the functionality to do this and installations using the Standard Industrial Fund System convert to that system.**
- c. Adjust the posting logic between the Defense Property Accountability System and the Standard Industrial Fund System to record**

the cost of assets transferred in without reimbursement in general ledger accounting code 5720, “Financing Sources Transferred In Without Reimbursement.”

Army Comments. The Deputy Assistant Secretary of the Army (Financial Operations) concurred with the recommendation and stated that his office will work with the Army Materiel Command and the Program Executive Officer, Enterprise Information Systems to develop the necessary requirements in the LMP system and GFEBS. However, he stated that developing the functionality in IFS to use the costs accumulated in the LMP system is unnecessary because GFEBS will subsume IFS in FY 2011. Instead, the Army will reconcile real property records and disclose any issues in its financial statements until implementation of GFEBS. In addition, the Army will work with system programmers to address the posting logic issue identified in Recommendation C.3.c. by September 2008.

Audit Response. The Army comments are partially responsive. We agree that the integration of IFS with LMP is unnecessary, based on the Army’s recent decision to subsume all real property accountability and accounting functions in GFEBS. However, the Army’s approach satisfies the intent of the recommendation only if the Army restricts the ability to record acquisition costs in IFS to installation resource managers, until the Army develops the required functionality in LMP. The current functionality in IFS does not provide for the proper separation of duties and ensure that financial transactions are correctly processed. Until GFEBS implementation, resource managers need to validate and populate the acquisition costs in IFS. We request that ASA(FM&C), in coordination with ACSIM, provide additional comments on Recommendation C.3.b.

C.4. We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller), in conjunction with the Director, Defense Finance and Accounting Service, develop as an interim measure a method to transfer the construction-in-progress costs accumulated by the U.S. Army Corps of Engineers to the appropriate Army Working Capital Fund installation receiving the related assets.

Army Comments. The Deputy Assistant Secretary of the Army (Financial Operations) concurred and stated that his office will work with DFAS and the U.S. Army Corps of Engineers to transfer the CIP costs to the appropriate AWCF installation. In addition, he requested that we include a list of U.S. Army Corps of Engineers projects identified as belonging to the AWCF as an appendix to the final report.

Defense Finance and Accounting Service Comments. The Director for DFAS Indianapolis Operations nonconcurred and stated that ASA(FM&C) should have the lead on resolving the recommendation. Because the Army has stewardship over the CIP balances, it must identify to DFAS which CIP balances each installation should report. The Director also stated that DFAS will work with the Army to jointly implement an interim method for transferring CIP cost balances to the appropriate AWCF installations.

Audit Response. The Army and DFAS comments are responsive. We agree that ASA(FM&C) should take the lead on this recommendation. The Army has responsibility for providing DFAS with the installation CIP balances for reporting on the appropriate financial statements. The Deputy Assistant Secretary stated in his comments on this recommendation that the Army will work with DFAS to develop the approach for transferring CIP costs to the appropriate AWCF installations. After reviewing the Army comments, we provided a detailed listing of the U.S. Army Corps of Engineers projects to the Office of the Deputy Assistant Secretary of the Army (Financial Operations).

Appendix A. Scope and Methodology

We conducted this performance audit from August 2006 through October 2007 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We determined whether the system controls over the AWCF real property assets were in place and provided reasonable assurance that the AWCF real property information was accurate and complete. We evaluated the real property files transferred between the real property management and accounting systems. Specifically, we obtained the September 30, 2006, database files from the Integrated Facilities System (IFS), the Defense Property Accountability System (DPAS), the DFAS Corporate Database/DFAS Corporate Warehouse (DCD/DCW), and the related files from the Standard Industrial Fund System and the Logistics Modernization Program system. Using Audit Command Language software, we reviewed the complete 2006 fiscal year-end database of AWCF accountability files to identify discrepancies. We compared the universe of IFS records to DPAS and DCD/DCW records to understand the flow of data between Army real property systems. Based on the results of our data analysis, we identified system control weaknesses, missing and erroneous data, and unnecessary manual intervention in the process.

We reviewed system manuals and interviewed U.S. Army Assistant Chief of Staff for Installation Management (ACSIM) personnel to understand the real property process and system interfaces. We compared the IFS data files with the IFS system manuals and documented any differences between what we expected and what existed in the IFS data files. We obtained documentation from ACSIM personnel about planned IFS changes and interviewed systems personnel concerning IFS current and future capabilities. We also reviewed the IFS system manuals to identify internal controls built into the system. Specifically, we reviewed the IFS system controls designed to ensure valid financial data, proper segregation of duties, and compliance with the DoD preponderance-of-use policy. We compared the DoD preponderance-of-use policy with the Statement of Federal Financial Accounting Standards No. 4 to assess whether the policy complied with GAAP. We also reviewed real estate agreements and lists of building occupants, in terms of square footage, to determine the preponderant users of buildings and other structures located on five judgmentally selected AWCF installations. We compared our analysis of the preponderant users to what the reporting entities recorded in IFS to determine whether the Army complied with the DoD preponderance-of-use policy.

We judgmentally selected assets at the five AWCF installations and traced real property transactions from the property management systems to the accounting systems to determine whether the Army real property data were accurate and complete. To assess financial reporting, we expanded our review to compare the process used by AWCF and AGF entities. In addition, we compared the AWCF

and AGF IFS data fields to determine differences. We obtained access to IFS for the five AWCF installations (Rock Island Arsenal, Illinois; Tobyhanna Army Depot, Pennsylvania; Anniston Army Depot, Alabama; Corpus Christi Army Depot, Texas; and Crane Army Ammunitions Activity, Indiana) and one AGF installation (Fort Belvoir, Virginia) to view the real property data. We also conducted site visits to the five AWCF installations to observe how they complied with DoD preponderance-of-use policy and recorded real property acquisitions, modifications, and deletions. We reviewed real property information reported on the FY 2005 AWCF Financial Statements and identified a sixth installation (Pine Bluff Arsenal, Arkansas) to test for compliance with the DoD preponderance-of-use policy. The following table shows the errors identified for the six AWCF installations, based on our review of real property data.

AWCF Installations Selected for Review		
Entity	Errors Found (millions)	Dates Visited
Rock Island Arsenal		October 16-27, 2006
Tobyhanna Army Depot	\$ 1.7	December 11-15, 2006
Anniston Army Depot	155.5	February 12-15, 2007
Corpus Christi Army Depot		February 12-16, 2007
Crane Army Ammunitions Activity		February 21-22, 2007
Pine Bluff Arsenal	267.1	Did not visit
Total	\$424.3	

Use of Computer-Processed Data. The Data Mining Directorate, Office of the Deputy Inspector General for Policy and Oversight, conducted limited tests of reliability on the data from IFS, DPAS, and DCD/DCW. They compared the files to the record layouts, verifying that record counts obtained from ACSIM, and DFAS personnel matched the file totals after importing them into the Audit Command Language software and reviewing the data for valid entries. We also relied on additional evidence to validate data reliability. We compared the IFS data for selected real property assets with physical documentation used to establish the records. We identified discrepancies in the records when we compared the data. We discuss discrepancies in the data and the related system control weaknesses in Findings B and C. In addition, we will issue a second report discussing internal control weaknesses and discrepancies between the data in IFS and the supporting documentation. Although we did not perform a formal reliability assessment of the computer-processed data, we determined that the data were sufficiently reliable to use in conjunction with physical documentation to test the controls over AWCF real property assets.

Use of Technical Assistance. The Data Mining Directorate imported the original files from IFS, DPAS, and DCD/DCW into the Audit Command Language software and conducted limited tests of reliability on the computer-processed data.

GAO High-Risk Areas. The GAO has identified several high-risk areas in DoD. This report provides coverage of the Managing Federal Real Property and DoD Financial Management high-risk areas.

Prior Coverage

During the last 5 years, GAO, the DoD Inspector General (DoD IG), and the U.S. Army Audit Agency have issued five reports discussing the processes and systems related to the financial reporting of AWCF and AGF real property assets. Unrestricted GAO reports can be accessed over the Internet at www.gao.gov. Unrestricted DoD IG reports can be accessed at www.dodig.mil/audit/reports.

GAO

GAO Report No. GAO-05-848T, “Further Actions Needed to Address Long-standing and Complex Problems,” June 22, 2005

DoD IG

DoD IG Report No. D-2007-087, “Internal Controls over Army General Fund Transactions Processed by the Business Enterprise Information Services,” April 25, 2007

DoD IG Report No. D-2006-072, “Internal Controls Related to Department of Defense Real Property,” April 6, 2006

Army

U.S. Army Audit Agency Report No. A-2006-0249-FFM, “Defense Property Accountability System Material Weakness Closeout,” September 28, 2006

U.S. Army Audit Agency Report No. A-2006-0066-FFM, “Integrated Facilities System Requirements Validation,” March 8, 2006

Appendix B. Glossary

Accounting System. An accounting system provides full general-ledger control over financial transactions and resource balances.

Accumulated Depreciation. The amount of depreciation expense accumulated over the useful life of the asset, which starts when the asset is placed in service.

Acquisition Cost. The acquisition cost includes all costs incurred to bring the asset to a form and location suitable for its intended use. Examples include amounts paid to vendors, transportation charges, and handling and storage costs.

Business Enterprise Information Services. Business Enterprise Information Services is an information system that includes the DFAS Corporate Database, the DFAS Corporate Warehouse, and the Defense Departmental Reporting System. The Business Enterprise Information Services processes nonstandard transactions from feeder systems through a series of complex filter and crosswalk tables, converts them to standard transactions, and posts them to the general ledger accounts.

Construction Agent. The construction agent is the U.S. Army Corps of Engineers, the Naval Facilities Engineering Command, or another approved DoD organization assigned the design or construction management responsibilities associated with a military construction program.

Construction-in-Progress (CIP). Construction-in-progress is the accumulation of construction costs charged to a project since its inception. It includes labor, materials, and overhead costs associated with project design, site preparation, and actual preparation.

Controlling Entity. The entity that is responsible and accountable for receiving, managing, and using Government assets in relation to its program or operations. Typically, the legislation establishing a program, appropriations act funding it, or related laws clearly identify which entity is responsible for the program.

Real Property. Real property consists of land, buildings, and other structures; improvements to owned or leased real property assets; and real property construction-in-progress.

Real Property Accountability Officer (RPAO). The real property accountability officer is the individual who accepts and accounts for buildings and other structures at an Army installation.

Real Property Management System. The Army's property management system maintains the real property inventory information for Army buildings, structures, land, and utilities. The real property management system serves as the basic source of information for each item of real property, including the asset's category, status, cost, area, capacity, condition, use, and capital improvements.

Subsidiary Ledger. The subsidiary ledger produces transactional data needed for the general ledger. For real property, the subsidiary ledger identifies location, quantity, acquisition date, cost, useful life, and other information.

Appendix C. Real Property Systems

Real Property Management Systems

The Army uses two systems to perform the functions related to AWCF and AGF real property management. The real property management systems generate financial transactions and send them to Army accounting systems.

Integrated Facilities System (IFS). Army installations use IFS as their primary real property management system. The Army implemented IFS in 1976 to perform real property management and sustainment functions. The system contains seven applications, including real property. Installation personnel use the real property function to track and report the use, assignment, and occupancy of owned and leased real property assets. The real property function allows users to:

- add real property asset records;
- classify real property assets as buildings, structures, utility distribution systems, or land;
- determine and maintain the proper facility category codes for each real property asset;
- record the space assignment of each real property asset;
- post real property capital increases and decreases;
- provide information for the Defense Property Accountability System reporting; and
- generate a variety of system-generated and user requested queries and reports.

Defense Property Accountability System (DPAS). In December 1994, the USD(C)/CFO designated DPAS as the system for property management and financial reporting of DoD personal and real property assets. DPAS obtains real property records, calculates depreciation, maintains subsidiary ledger files, and sends financial transactions to the financial management systems. When initially fielded, IFS did not have the functionality to calculate and report the depreciated (book) value of real property assets. In December 1999, the Army implemented a two-way interface between DPAS and IFS to provide an integrated process to account for and report all Army real property. The Army implemented the interface at 12 installations supporting the AWCF Industrial Operations activity group.

IFS sent DPAS all real property records that met the DoD capitalization threshold, which DPAS used to calculate depreciation. DPAS returned the following four files to IFS:

- Rejected records,
- Mismatched capitalization records,
- Current accumulated depreciation amounts, and
- New capitalization records added by DPAS.

AWCF Accounting Systems

The AWCF Industrial Operations activity group uses two accounting systems to report real property financial information. The Standard Industrial Fund System (SIFS) is a legacy accounting system used by 12 of the 13 installations supporting the AWCF Industrial Operations activity group. The Army initially fielded the Logistics Modernization Program (LMP) system at select locations in July 2003, including Tobyhanna Army Depot. It is the future AWCF accounting system. In March 2006, the Army Program Executive Office, Enterprise Information Systems assumed responsibility for the future fielding and system functionality of LMP. DPAS sends real property financial transactions to SIFS and LMP to post to the appropriate general ledger accounts. The Supply Management, Army activity group uses the Standard Operations and Maintenance, Army Research and Development System as its accounting system. Resource managers must prepare journal vouchers to enter real property information into the Standard Operations and Maintenance, Army Research and Development System because DPAS does not send it information directly.

Appendix D. Memorandum to the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

MAY 24, 2007

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER),
ACCOUNTING AND FINANCE POLICY

SUBJECT: Replacing "Preponderance of Use" Policy with Imputed Costing

Executive Summary. The Department of Defense Office of Inspector General (DoD OIG) recommends that the Under Secretary of Defense (Comptroller)/ Chief Financial Officer (USD[C]/CFO) rescind the current DoD preponderance of use policy. The USD(C)/CFO should require DoD entities to recognize the cost of their use of partially reimbursed or nonreimbursed real property assets by recording imputed financing sources¹ and related costs. The DoD preponderance of use policy is not consistent with accounting principles generally accepted in the United States, whereas the imputed financing policy we propose is consistent with Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," July 31, 1995, as amended.

Introduction. United States Code, Title 10, Section 2682, precludes DoD entities other than the Military Departments² from owning or holding title to real property assets. However, other DoD entities, such as the Defense agencies and the Components of the Defense working capital fund, use DoD-owned real property assets to accomplish their missions, usually without reimbursing the Military Department that owns the assets. Consequently, these entities do not fully report the cost of their operations on their stand-alone financial statements, contrary to accounting principles generally accepted in the United States.

Federal Accounting Standards Advisory Board. The Office of Management and Budget requires DoD to adhere to the Federal financial accounting standards developed by the Federal Accounting Standards Advisory Board. SFFAS No. 4 requires Federal reporting entities to report the full cost of their outputs in their general financial reports. SFFAS No. 4, Interpretation No. 6, "Accounting for Imputed Intra-departmental Costs," April 18, 2003, explains that reporting entities should account for imputed intra-departmental costs³ in accordance with the full cost provisions of SFFAS No. 4. SFFAS No. 30, "Inter-Entity Cost Implementation," April 15, 2005, modified SFFAS No. 4. It changed the effective date for full implementation to reporting periods after September 30, 2008, with earlier implementation encouraged.

¹ Imputed financing is the amount of cost absorbed by one Federal entity that benefits another Federal entity. This amount will equal the imputed costs reported on the Statement of Net Cost.

² Departments of the Army, Navy, and Air Force.

³ Imputed intra-departmental costs are the unreimbursed portion of the full costs of goods and services received by the entity from a providing entity that is part of the same department or larger reporting entity (i.e. other bureaus, Components or responsibility segments within the department or larger reporting entity).

SFFAS No. 4 Requirements. The relevant principles in SFFAS No. 4 are straightforward. DoD entities are supposed to report the full cost of their outputs in general purpose financial statements. This should include the sum of:

- the cost of resources consumed that directly or indirectly contribute to the output, and
- the cost of identifiable supporting services provided by other entities, known as inter-entity costs.

SFFAS No. 4 limits the recognition of unreimbursed inter-entity costs to material items that the entity providing the asset can identify with reasonable precision.

SFFAS No. 4 states that each entity's full cost should incorporate the full cost of goods and services that it receives from other entities. The entity providing the goods or services has the responsibility to provide the receiving entity with information on the full cost of such goods or services through billing or other means of advice. When an entity uses a facility but does not fully reimburse its owner, that entity receives a benefit paid for by the providing entity that it recognizes as an imputed financing source. The entity can then recognize these imputed costs as part of their full cost of doing business.

DoD Preponderance of Use Policy. In an attempt to comply with SFFAS No. 4 requirements, the OUSD(C)/CFO established complicated accounting requirements for tracking and assigning nonreimbursed costs to the DoD entity using real property assets. The DoD Financial Management Regulation (FMR) 7000.14-R, Volume 4, Chapter 6, "Property, Plant and Equipment (PP&E)," July 2006, states that the legal ownership (i.e., having title to a General PP&E asset) usually, but not always, is the primary factor for determining which DoD Component recognizes a General PP&E asset for accounting and financial statement reporting purposes. On the other hand, the manner in which DoD purchased the asset does not determine what entity accounts for and reports a real property asset. For example, a Military Department may have paid for the construction or acquisition of buildings used by a working capital fund entity, but the working capital fund entity should capitalize, depreciate, and report these buildings on its financial statements. Such accounting and reporting is required by working capital fund entities regardless of whether title to such buildings is passed to the local installation when construction is completed. When determining which DoD Component must recognize a General PP&E asset for accounting and financial statement reporting purposes, the reporting DoD Component must meet all four of the following criteria:

- The Component must anticipate a probable future benefit (related to use of the asset) that will contribute to the reporting Component's operations. In applying this criterion, the concept of benefit has traditionally been referred to as "service capacity" (the ability of an asset to directly assist the Component in achieving its mission). Service capacity has value because it is consumable or exchangeable for other benefits. For example, a building on a military installation or a piece of equipment provided to a Defense agency may allow that agency to achieve its mission. The Defense agency also pays for utilities, maintenance, and upkeep of the asset. The exchangeability part of the benefit criterion (the ability to sell, trade or donate, the property) need not be present for an item to qualify as an asset in the Federal sector, if use of the item provides benefit to the reporting Component. The inability of the Component to exchange the benefit

for other benefits does not preclude the asset from meeting this criterion.

- The DoD Component that reports the asset must be able to obtain the benefit and control access to the benefit inherent in the asset. This criterion, “control over the benefit,” refers to an entity’s ability to direct who derives the benefit, the timing of when the benefit is derived, and under what conditions it is derived. Directing the use of the benefit has traditionally reflected possession or the ability to exert significant influence over the benefits, which is obtained through either legal ownership or an expressed or implied agreement with the owner. In instances when an entity maintains possession of property through agreements that provide for possession for as long as needed, without a termination date and without reimbursement, such arrangements are generally considered as providing sufficient influence over the use of the property to satisfy the criterion, control over the benefits. Once termination occurs, however; (for instance closing of the base where an entity conducts operations or the decommissioning of an aircraft) control no longer exist. In such a case, the property will no longer meet the criterion, control over the benefit of the asset.
- The DoD Component must have entered into the agreement or event giving it the right to (and control over) the benefit of a General PP&E asset before the asset is reported on its (the preponderant user’s) financial statements. This criterion refers to an agreement (express or implied) that allows a DoD Component to occupy and use the asset without reimbursement for as long as needed. If the transaction of the event occurs at the end of the fiscal year reporting period, that DoD Component, who is the predominant user must report the asset and the associated depreciation expense on the financial statements.
- A Component who is the preponderant user of a General PP&E asset owned by another DoD Component needs to report the asset only when the cost of the asset, taken as a whole, is material to the preponderant user’s financial statements. This is in keeping with the concept that the full cost of each entity’s mission should incorporate all costs for goods and services paid for on their behalf by other entities. The recognition of full cost is limited to material items or amounts that are significant to the receiving entity and form an integral or necessary part of the receiving entity’s mission.

The DoD FMR applies the preponderance of use policy differently depending on whether the preponderant user reports its assets on a Military Department general fund, Defense general fund, or a Defense working capital fund’s financial statement. When an entity of the Defense general fund or one of the working capital funds is the preponderant user of a real property asset owned by a Military Department, the preponderant user reports and depreciates the asset on its financial statements. However, when a Military Department general fund entity is the preponderant user of another Military Department’s real property asset, the Military Department owning the asset reports the asset on its financial statement. The real property asset is not reported on the preponderant user’s financial statements.

Contrasting DoD Preponderant User Policy with Full Cost Reporting. The DoD preponderance of use policy inappropriately allows entities to financially report real

property assets that they do not own. In addition, the policy requires the preponderant user to record the full cost of the asset on its financial statements, which would include the costs of operations of the non-preponderant users. This policy overstates the cost of operations on financial statements of the preponderant user, while understating the cost of operations of the real property asset's owner and other tenants using the asset. The DoD FMR also does not require the preponderant user to report the source of financing for use of the asset on its financial statements. This is contrary to SFFAS No. 4, which requires an entity to disclose the source of financing even if the asset was funded via imputed financing received from the owner of the asset.

Real Property Inventory Requirements. The Deputy Undersecretary of Defense (Installations and Environment) (DUSD[I&E]) initiated the Real Property Inventory initiative to improve DoD's real property inventory process. The initiative addresses the alignment of DoD business management activities and decision making with the Defense Installations Strategic Plan, emerging Federal Real Property Council requirements, and the President's Management Agenda.

The Real Property Inventory Requirements (RPIR) document, issued by DUSD(I&E) addresses the DoD enterprise yet-to-be realized real property environment and the preponderance of use policy. The RPIR document describes the preponderance of use reporting of real property assets as an intermediate solution to account for the cost of real property assets and capital improvements. The RPIR document acknowledges that application of the preponderant user policy may overstate costs for the preponderant user of the facility and understate the costs for other tenant organizations. This happens because the preponderance of use policy does not require the non-preponderant user to recognize the costs associated with use of the real property unless it becomes the preponderant user. The RPIR document makes no recommendations to amend the current process but identifies the need to comply with SFFAS No. 4. The RPIR document identifies the long-term need to assign each DoD entity its share of expenditures and costs for the use of assets it occupies.

Missile Defense Agency (MDA) White Paper. An MDA White Paper analysis identified significant issues related to preponderance of use in financial reporting by Defense agencies. The MDA concerns included recording assets on the financial statements without a corresponding need for asset accountability, and recording and depreciating Defense agency-funded capital improvements on the financial statement of a Military Department that owns the facility when the Defense agency is not the preponderant user.

Challenges to Implementing the DoD Policy. Implementing the preponderance of use policy is a significant challenge to DoD entities. Real property accountability officers maintain records on real property but do not accurately identify and report the preponderant users of these facilities. Effective implementation of the policy requires DoD entities preparing financial statements to research each item of real property and determine which DoD entity is the preponderant user for financial reporting purposes. The DoD preponderance of use policy further requires that the preponderant user verify that the Department only reports the asset once on the DoD Agency-wide financial statements.

During our Audit of Controls Over Army Working Capital Fund (AWCF) Real Property Assets (Project No. D2006-D000FI-0249.000), we found that installation-level personnel at five AWCF Industrial Operations installations were not effectively implementing the preponderance of use policy. Many real property specialists found the policy confusing and difficult to implement. None of these five Industrial Operations

installations correctly identified and reported the preponderant user of real property assets.

These AWCF Industrial Operations installations generally reported all real property assets located on their installation as part of the AWCF whether they were the preponderant user or not. This practice misrepresents the total assets of the AWCF and does not accurately reflect the full cost of accomplishing the AWCF business area operations. This practice also substantially misstates the assets and related costs reported in AWCF and other DoD entity financial statements. In addition, it excludes costs that the business area should include in computing its rates.

A high risk exists that multiple DoD entities will report the acquisition cost or value of a real property asset under the DoD preponderance of use policy. The policy requires an extensive reconciliation between the real property owner and tenant organizations to preclude double reporting.

DoD OIG Position. The current DoD preponderance of use policy does not comply with accounting principles generally accepted in the United States. The policy significantly misrepresents the full costs associated with Defense agencies and working capital funds providing goods and services. In implementing the preponderance of use policy, tenants and smaller users do not report any cost for the use of real property and DoD entities do not effectively identify the imputed financing sources expended in performing their missions. In addition, DoD entities may not be able to effectively implement and maintain the policy. We recommend that the USD(C)/CFO:

- Rescind the preponderance of use policy.
- Develop an allocation method for assigning imputed costs for real property assets on a prorated basis to the users of assets.
- Require users to recognize the cost of real property by recognizing imputed financing sources and expensing an imputed cost for the use of partially or non-reimbursed assets and reporting those amounts on their financial statements.

This accounting treatment would comply with accounting principles generally accepted in the United States and result in financial statements that more accurately reflect the full cost of operations. Please direct any questions to Ms. Barbara A. Sauls at (703) 325-5782 (DSN 221-5782) or Mr. Carmelo G. Ventimiglia at (317) 510-4801 (DSN 699-4801) ext. 275.



Paul J. Granetto, CPA
Assistant Inspector General and Director
Defense Financial Auditing Service

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Technology, and Logistics
Director, Acquisition Resources and Analysis
Under Secretary of Defense (Comptroller)/Chief Financial Officer
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Deputy Under Secretary of Defense for Business Transformation
Director, Program Analysis and Evaluation

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army
Program Executive Officer, Enterprise Information Systems
Assistant Chief of Staff for Installation Management

Department of the Navy

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Senate Committee on Appropriations

Senate Subcommittee on Defense, Committee on Appropriations

Senate Committee on Armed Services

Senate Committee on Homeland Security and Governmental Affairs

House Committee on Appropriations

House Subcommittee on Defense, Committee on Appropriations

House Committee on Armed Services

House Committee on Oversight and Government Reform

House Subcommittee on Government Management, Organization, and Procurement,

Committee on Oversight and Government Reform

House Subcommittee on National Security and Foreign Affairs,

Committee on Oversight and Government Reform

Under Secretary of Defense (Comptroller)/Chief Financial Officer Comments



OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

COMPTROLLER

DEC 5 2007

MEMORANDUM FOR PROGRAM DIRECTOR, DEFENSE FINANCIAL AUDITING SERVICE, OFFICE OF INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Comments to Draft Audit Report, "Controls Over Army Real Property Financial Reporting," (Project No. D2006-D000FI-0249.000)

This memorandum is in response to your request for comments to the subject draft audit report, issued November 06, 2007.

We partially concur with the Office of Inspector's General, Department of Defense recommendation: A.1) the OUSD (C)/CFO rescind the DoD preponderance of use policy and develop new business rules for defining financial control over real property assets and implement a costing methodology that complies with the Statement of Federal Financial Accounting Standards No. 4. We concur with recommendation: C.1) OUSD (C) /CFO will update the Department of Defense Financial Management Regulation ("DoDFMR") to require DoD entities to record transfers in of assets in general ledger account 5720, "Financing Sources Transferred In Without Reimbursement". Our response is attached.

We appreciate the opportunity to respond to your request for comments on the audit recommendations. My point of contact is Ms. Kim Laurance. She can be reached at 703-697-8281 or email kim.laurance@osd.mil.

James E. Short
Deputy Chief Financial Officer

Attachment:
As stated

DOD OIG DRAFT REPORT DATED AUGUST 28, 2007
PROJECT NO. D2006-D000FI-0249.000
“CONTROLS OVER ARMY REAL PROPERTY FINANCIAL REPORTING”

**OFFICE OF THE UNDER SECRETARY OF DEFENSE (COMPTROLLER)
(OUSD)(C) COMMENTS TO THE DOD OIG RECOMMENDATIONS**

RECOMMENDATION A.1: Recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer (USD(C)/CFO) rescind the DoD preponderance of use policy and develop new business rules for defining financial control over real property assets and implement a costing methodology that complies with the Statement of Federal Financial Accounting Standards No. 4. Specifically, the business rules should require DoD entities:

- a. Report any real property assets or capital improvements constructed using their funds on their financial statements unless they formally transfer financial control of the asset to another entity.
- b. Identify and allocate any costs incurred on the behalf of other users occupying the assets under their control. Inform the users of the allocated costs and either obtain full reimbursement or direct them to record an imputed cost and a corresponding imputed financing source on their financial statements to recognize the unreimbursed benefit.

USD(C) RESPONSE TO RECOMMENDATION A.1: Partially concur. The USD(C)/CFO is developing new business rules for defining financial control over real property assets and implementing a costing methodology that complies with SFFAS No. 4. The USD (C)/CFO is:

- a. Updating the DoD FMR volume 4, chapter 6, Property, Plant, and Equipment to clarify, and define control and reporting of real property assets and associated costs. This is not a rescission of policy.
- b. Working closely with OSD Acquisition Technology & Logistics to define scenarios for real property reporting and imputed costs to include in the updated DoD FMR. Imputed cost is currently in the DoD FMR, volume 4, chapter 17, under “Expenses and Miscellaneous Items”; however, we will update this information and cross reference volume 4, chapter 17 via a link to chapter 6.

Estimated completion date: September 30, 2008

RECOMMENDATION C.1: Recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer update the DoD Financial Management Regulation, volume 10B, "Reimbursable Operations, Policy, and Procedures – Working Capital Funds, chapter 58, "Capital Assets," to require DoD entities to record transfers in of assets in general ledger accounting code 5720, "Financing Sources Transferred In Without Reimbursement."

USD(C) RESPONSE TO RECOMMENDATION C.1: Concur. The USD(C)/CFO is updating the DoD FMR volume 11B (vice 10B in your recommendation), chapter 58, "Capital Assets," to reflect the use of the applicable US Standard General Ledger (USSGL) accounts for recording proprietary and budgetary transactions that map to the general property, plant and equipment line on the balance sheet.

Estimated completion date: September 30, 2008

Revised
Recommendation to
DoD FMR,
volume 11B

Department of Army Comments



REPLY TO
ATTENTION OF

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY OF THE ARMY
FINANCIAL MANAGEMENT AND COMPTROLLER
109 ARMY PENTAGON
WASHINGTON DC 20310-0109
JAN 8 2008

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE, 400 ARMY NAVY DRIVE, ARLINGTON, VIRGINIA,
22202-4704

SUBJECT: DODIG Draft Audit Report: Controls Over Army Real Property Financial Reporting (Project D2006-D000FI-0249.000; dated November 6, 2007)

1. Attached is the Army's reply to the subject draft audit report. We have coordinated the reply with the functional stakeholders from the Army Budget Office (Business Resources), Office of the Assistant Chief of Staff for Installation Management, and the Army Materiel Command.
2. We generally agree with the report. The Army is in the process of business transformation efforts for real property assets that will directly address the recommendations in this audit report. Based on the current General Fund Enterprise Business System (GFEBS) milestones, we anticipate full implementation of the actions related to this report by FY 2011.

Though recommendation A.1. is addressed to Under Secretary of Defense (Comptroller)/Chief Financial Officer, the Army will be directly impacted by the costing methodology developed should the Under Secretary of Defense (Comptroller)/Chief Financial Officer rescind the preponderance of use policy. In addition, the Army will establish business rules based on any fully-coordinated costing methodology that the Under Secretary of Defense (Comptroller)/Chief Financial Officer issues.

3. To ensure that the Army implements the recommendations and develops the required internal controls in the processes, we will track actions toward implementing these recommendations in the Army CFO Strategic Plan. We will add tasks to the Plan during the 2nd quarter, FY 2008.
4. My point of contact for real property financial reporting is Mr. Marlin Erickson at 703-693-3384 or by e-mail at marlin.erickson@us.army.mil.


John J. Argodale
Deputy Assistant Secretary of the Army
(Financial Operations)

Attachment

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**Draft DoDIG Report
Controls Over Army Real Property Financial Reporting
Project # D2006-D000FI-0249.000 November 6, 2007**

Recommendation A.2. We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller):

- a. Identify the facilities funded and occupied by an Army General Fund entity that are located at the Army Working Capital Fund installations and report them on the Army General Fund financial statements.

Management Comments. Concur. We will work with the Office of the Assistant Chief of Staff for Installation Management (OACSIM) to identify facilities and will record them in the financial statements in accordance with the costing methodology that the Under Secretary of Defense (Comptroller)/Chief Financial Officer develops per Recommendation A.1.

- b. Train installation financial managers and Real Property Accountability Officers and then ensure that they comply with the business rules that the Under Secretary of Defense (Comptroller)/Chief Financial Officer establishes for implementing a real property costing methodology.

Management Comments. Concur. We will work with the OACSIM to incorporate business rules to implement the costing methodology OSD develops (per Recommendation A.1.) in their training and orientation for Real Property Officers. We will also seek joint training opportunities within the financial and real property communities.

ATTACHMENT

1

Recommendations (Cont.):

Recommendation B.1. We recommend that the U.S. Army Assistant Chief of Staff for Installation Management, Assistant Secretary of the Army (Financial Management and Comptroller), and Deputy Director for Operations, Defense Finance and Accounting Service, develop an interim business process for financially reporting Army General Fund and Army Working Capital Fund real property assets. Specifically, the Army and Defense Finance and Accounting Service should:

- a. Use the Defense Finance and Accounting Service Corporate Database/Defense Finance and Accounting Service Corporate Warehouse as the subsidiary ledger file for real property assets that Army manages.
- b. Establish a uniform monthly cutoff date for updating capitalization records, calculating depreciation, and recording the applicable financial transactions to the appropriate trial balances that support the values reported on the Army financial statements.
- c. Develop a uniform process for Army Working Capital Fund entities to retrieve from the Defense Finance and Accounting Service Corporate Database/Defense Finance and Accounting Service Corporate Warehouse all real property financial transactions needed to support installation financial reporting requirements.
- d. Perform a comprehensive reconciliation between the Integrated Facilities System, Defense Property Accountability System, and the accounting systems real property data to ensure subsidiary records are accurate and complete.
- e. Require resource managers to periodically conduct reconciliations between the subsidiary ledger files in the Integrated Facilities System and information in the Army Working Capital Fund accounting systems.
- f. Upon full implementation of Recommendation B.1.c.:
 - (1) Establish in the Army Working Capital Fund Integrated Facilities System databases the ability to calculate depreciation on a specific cutoff date, maintain subsidiary ledger files, and update the Defense Finance and Accounting Service Corporate Database/Defense Finance and Accounting Service Corporate Warehouse with all real property data.
 - (2) Terminate the system interface between the Integrated Facilities System and the Defense Property Accountability System and discontinue using the Defense Property Accountability System for reporting Army Working Capital Fund real property assets.

Management Comments. Partially Concur. Uniform processes for financially reporting Army Working Capital Fund assets and periodic reconciliations of Army Working Capital Fund assets – as recommended above - are part of our ongoing Business Transformation efforts and General Fund Enterprise Business System (GFEBS) conversion preparations. Because Real Property reporting is undergoing transformation through OSD directives and the General Fund Enterprise Business System, the Army will consider interim business processes that can be implemented should there be a substantial delay in General Fund Enterprise Business System implementation. We will ensure that those interim processes include establishing a subsidiary ledger file in the Business Enterprise Information Systems' Corporate Database/ Corporate Warehouse and includes system change packages/ temporary work-around processes for affected systems, as needed.

Recommendation B.2. We recommend that the U.S. Army Assistant Chief of Staff for Installation Management, in conjunction with the U.S. Army Program Executive Officer, Enterprise Information Systems, develop plans to integrate the Integrated Facilities System with the Logistics Modernization Program System and the General Fund Enterprise Business system so that the capability exists to generate a subsidiary ledger file at the installation level that supports the Army General Fund and Army working Capital Fund financial statements.

Management Comments. Partially Concur. The response to recommendation B.1. above also applies to this recommendation. In addition, because we plan for GFEBS to subsume the IFS, there is no need to create an interface between IFS and GFEBS. We will continue to integrate IFS with DPAS to pull the Working Capital Fund real property depreciation information in the interim until GFEBS is fully deployed.

Recommendation C.2. We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller), in conjunction with the Army Program Executive Officer, Enterprise Information Systems, develop within the Logistics Modernization Program and General Fund Enterprise Business Systems, an integrated process to:

- a. Receive construction costs directly from any construction agent's accounting system.
- b. Record internal costs incurred in the construction of a capital asset to the corresponding project's Construction-in-Progress account.

Management Comments. Concur. We will include processes for recording Construction-in-Progress (CIP) in the real property transformation efforts discussed in our reply to Recommendation B.1. Prior to GFEBS' full operating capability, the Army will use the Headquarters Installation Information System (HQIIS) to record construction costs directly from construction agents' accounting systems and pass it to the appropriate accountable organizations for financial reporting.

Recommendation C.3. We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller), in conjunction with the Army's Assistant Chief of Staff for Installation Management, develop and implement a process to establish an asset's acquisition cost based on the costs previously accumulated in the accounting systems' Construction-in-Progress (CIP) accounts. Specifically:

- a. Develop the functionality in the Integrated Facilities System to use the costs accumulated in the Logistics Modernization Program system's Asset Under Construction accounts as the asset's acquisition costs whenever an Army Working Capital Fund installation places an asset in service.
- b. Require resource managers to manually enter acquisition costs, including any internal costs, in the Integrated Facilities System based on the journal vouchers received from construction agents when placing an asset in service. The Army should maintain this process until the Logistics Modernization Program system has the functionality to perform this function and installations using the Standard Industrial Fund System convert to that system.
- c. Adjust the posting logic between the Defense Property Accountability System (DPAS) and the Standard Industrial Fund System (SIFS) to record the cost of assets transferred in without reimbursement in general ledger accounting code 5720, "Financing Sources Transferred In Without Reimbursement."

Management Comments. Concur. We will work with the Army Materiel Command and the Program Executive Officer Enterprise Integration Systems to

develop the necessary requirements in LMP and GFEBS. For Recommendation C.3.b., there will be no need to implement a manual process since the real property functionality for AWCF real property will be implemented in GFEBS during FY 2011. Prior to the conversion process, we will reconcile all real property asset records. In addition, we will include disclosures in the financial statements that identify issues with reporting real property assets. For Recommendation C.3.c., we will work with the SIFS and DPAS program managers to determine the best approach to adjusting the posting logic. Our target date for developing and executing the approach is 4th QTR, FY 2008.

Recommendation C.4. We recommend that the Director, Defense Finance and Accounting Service, in conjunction with the Assistant Secretary of the Army (Financial Management and Comptroller), develop as an interim measure a method to transfer the construction-in-progress costs accumulated by the U.S. Army Corps of Engineers to the appropriate Army Working Capital Fund installation receiving the related assets.

Management Comments. Concur. The Army will work with the Defense Finance and Accounting Service and the U.S. Army Corps of Engineers to develop the approach for transferring construction-in-progress costs to the appropriate Army Working Capital Fund installations. The report stated that "USACE had accumulated \$13.4 million in Construction-in-Progress (CIP) costs for construction projects at the five AWCF installations we visited" but did not provide sufficient details to enable us to determine how to distribute the costs. In order for the Army to correct the reporting, we request the Inspector General identify the specific projects by installation as an appendix to the final report.

Defense Finance and Accounting Service Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE
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DEC 11 2007

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Department of Defense, Inspector General Draft Report, "Controls over Army Real Property Financial Reporting," (Audit Project Number. D2006-D000FI-0249.000)

Indianapolis Operations is providing management comments to the following recommendations:

Recommendation B.1. We recommend that the U.S. Army Assistant Chief of Staff for Installation Management, Assistant Secretary of the Army (Financial Management and Comptroller), and Deputy Director for Operations, Defense Finance and Accounting Service, develop an interim business process for financially reporting Army General Fund and Army Working Capital Fund real property assets. Specifically, the Army and Defense Finance and Accounting Service should:

- a. Use the Defense Finance and Accounting Service Corporate Database/Defense Finance and Accounting Service Corporate Warehouse as the subsidiary ledger file for real property assets that Army manages.
- b. Establish a uniform monthly cutoff date for updating capitalization records, calculating depreciation, and recording the applicable financial transactions to the appropriate trial balances that support the values reported on the Army financial statements.
- c. Develop a uniform process for Army Working Capital Fund entities to retrieve from the Defense Finance and Accounting Service Corporate Database/Defense Finance and Accounting Service Corporate Warehouse all real property financial transactions needed to support installation financial reporting requirements.
- d. Perform a comprehensive reconciliation between the Integrated Facilities System, Defense Property Accountability System, and the accounting systems real property data to ensure subsidiary records are accurate and complete.
- e. Require resource managers to periodically conduct reconciliations between the subsidiary ledger files in the Integrated Facilities System and information in the Army Working Capital Fund accounting systems.
- f. Upon full implementation of Recommendation B.1.c.
 - (1) Establish in the Army Working Capital Fund Integrated

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Facilities System databases the ability to calculate depreciation on a specific cutoff date, maintain subsidiary ledger files, and update the Defense Finance and Accounting Service Corporate Database/Defense Finance and Accounting Service Corporate Warehouse with all real property data.

- (2) Terminate the system interface between the Integrated Facilities System and the Defense Property Accountability System and discontinue using the Defense Property Accountability System for reporting Army Working Capital Fund real property assets.

Management Comments: Non-concur. Indianapolis Operations recommends that the Inspector General, Department of Defense redirect recommendation B.1. to the Business Transformation Agency (BTA). Beginning FY 2008, systems development and initiatives, including the Defense Corporate Database/Defense Corporate Warehouse, were transferred to the BTA and no longer managed by Defense Finance and Accounting Service.

Estimated Completion Date: Not applicable.

Recommendation C.4. We recommend that the Director, Defense Finance and Accounting Service, in conjunction with the Assistant Secretary of the Army (Financial Management and Comptroller), develop an interim measure a method to transfer the construction-in-progress (CIP) costs accumulated by the U.S. Army Corps of Engineers to the appropriate Army Working Capital Fund installation receiving the related assets.

Current Management Comments: Stakeholder: Noah Sturgeon, 317-510-2620. Non-concur. Indianapolis Operations recommends that the Inspector General, Department of Defense re-write recommendation C.4. to state that the Assistant Secretary of the Army (Financial Management and Comptroller) [ASA (FM&C)] will lead the initiative for completing the recommendation with Indianapolis Operations support. First, the ASA (FM&C) must identify the CIP costs balances to be transferred before Indianapolis Operations and ASA (FM&C) can jointly implement an interim method for transferring CIP costs balances to the appropriate Army WCF installation receiving the related assets. The ASA (FM&C) has complete stewardship over CIP costs balances. An estimated completion date (ECD) for implementing an interim method is contingent upon the ASA (FM&C's) ECD for identifying the CIP costs balances to be transferred.

Redirected
Recommendation

Estimated Completion Date: To be determined.

My point of contact is Virginia Fortune, Chief, Army Budget/Audited Financial Statements Division, 317-510-6192.

Audrey L. Echhart
Steve R. Bonta
Director, Indianapolis Operations

Team Members

The Department of Defense Office of the Deputy Inspector General for Auditing, Defense Financial Auditing Service prepared this report. Personnel of the Department of Defense Office of Inspector General who contributed to the report are listed below.

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